

2004-2081Z

# *Sustainable Advantage*



**PEPSICO**  
2004

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On the cover: A shopping cart overflows with our 18 brands that each sell more than \$1 billion at retail annually.

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When market or market share are referred to in this report, the markets and share are defined by the sources of the information, primarily Information Resources, Inc. and ACNielsen. The Measured Channel information excludes Wal-Mart as Wal-Mart does not report volume to these services.



Three major sustainable advantages give PepsiCo a competitive edge as we operate in the global marketplace. Making it all work are our extraordinarily talented and dedicated people.

## Financial Highlights

PepsiCo, Inc. and Subsidiaries

(\$ in millions except per share amounts; all per share amounts assume dilution)

	2004	2003	% Chg <sup>(a)</sup>
<b>Summary of Operations</b>			
Total net revenue	\$29,261	\$26,971	8
Division operating profit	\$6,098	\$5,463	12
Total operating profit	\$5,259	\$4,781	10
Net income <sup>(b)</sup>	\$4,004	\$3,560	12
Earnings per share <sup>(b)</sup>	\$2.32	\$2.05	13
<b>Other Data</b>			
Management operating cash flow <sup>(c)</sup>	\$3,705	\$3,032	22
Net cash provided by operating activities	\$5,054	\$4,328	17
Capital spending	\$1,387	\$1,345	3
Common share repurchases	\$3,028	\$1,929	57
Dividends paid	\$1,329	\$1,070	24
Long-term debt	\$2,397	\$1,702	41

(a) Percentage changes above and in text are based on unrounded amounts.

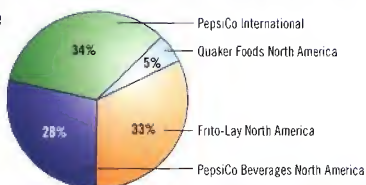
(b) Excludes certain tax benefits and restructuring and impairment charges. See page 88 for reconciliation to net income and earnings per share on a GAAP basis.

(c) Includes the impact of net capital spending. Also, see "Our Liquidity, Capital Resources and Financial Position" in Management's Discussion and Analysis.

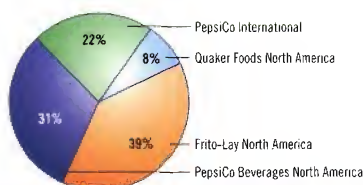
# PepsiCo at a Glance

\$ in Millions

**Net Revenue**  
Total: \$29,261



**Division Operating Profit**  
Total: \$6,098



## Frito-Lay North America



**Net Revenue**



**Operating Profit**



## PepsiCo Beverages North America



**Net Revenue**



**Operating Profit**



## PepsiCo International



**Net Revenue**



**Operating Profit**



## Quaker Foods North America



**Net Revenue**



**Operating Profit**







**Steve Reinemund**  
Chairman and Chief Executive Officer

## Dear Shareholders:

PepsiCo's 2004 performance was strong and on target, as we advanced our vision for global leadership in convenient foods and beverages in important ways. Your portfolio of businesses and leading brands across the world delivered exactly as it was designed to perform, with growth across every division.

- Volume grew 6%.
- Division net revenue grew 8%.
- Division operating profit grew 12%.
- Earnings per share grew 13%. \*
- Total return to shareholders grew 14%, compared with 11% for the S&P.
- PepsiCo shares grew 12%, compared with 9% for the S&P.
- Cash flow from operations was \$5.1 billion and management operating cash flow was more than \$3.7 billion.

As proud as we are of this performance, we know that our shareholders care most about our future. Given PepsiCo's consistent record of growth, one of the most common questions we're asked is:

### *How will you sustain growth?*

By taking our competitive strengths, and investing in them to create longer-term value. That may sound a bit simplistic, but here's what I mean.

PepsiCo has three key advantages:

1. big, muscular brands,
2. the proven ability to innovate and create differentiated products, and
3. powerful go-to-market systems.

What makes this all work are the extraordinarily talented, dedicated people at PepsiCo.

When we take those competitive advantages, and invest in them with dollars generated from top-line growth and cost saving initiatives, we sustain a value cycle for our shareholders.

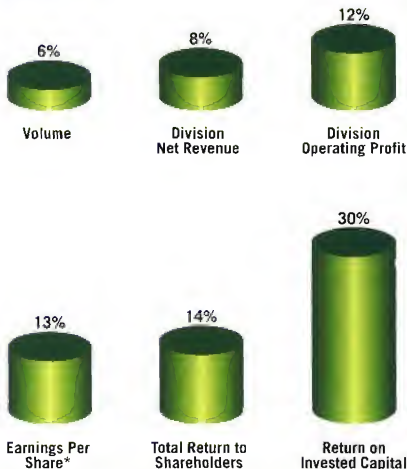
In essence, investing in innovation fuels the building of our brands; this in turn drives top-line growth. Dollars from that top-line growth are strategically reinvested back into new products and other innovation, along with cost savings projects, and thus the cycle continues.

### *Your cycle of reinvestment relies on your ability to grow brands. Are PepsiCo's brands up to the challenge?*

Yes. With 16 brands that each generate over a billion dollars of retail sales annually, and many more moving in that direction, we have big "global icon" brands that sit squarely in the sweet spot of convenience. We constantly differentiate those brands in the marketplace by what we do with ingredients and nutrition science, product packaging and processing. And, we create points of difference with marketplace solutions in our retail environment, exciting the consumers who ultimately buy our products.

We have more of these icon brands than any other food and beverage company in the world, and we continue to add new products to the portfolio through internal innovations combined with smaller, tuck-in acquisitions in our international businesses.

### 2004 Scorecard



\* See page 88



## How do you invest in, and differentiate, PepsiCo's brands?

We invest in many ways, including advertising and merchandising. I'd say innovation is the most impactful option. Innovation lives at the core of any successful consumer products company. Our organization is structured to capture consumer insights, and customer — or retailer — insights as well. Strategically, we look at innovation in three ways, or types. "Type A" innovation is what we call "close-in" — ideas such as new flavors of existing products.

"Type B" innovation is represented in new products delivering additional benefits or meeting specific consumer preferences, but generally within existing brands. For example, Tostitos Scoops tortilla chips, Lay's Stax potato crisps or Tropicana Light'n Healthy beverages are products more incremental to the business than Type A.

"Type C" innovation is focused on new platforms, like delivering chilled products directly to the store; or entirely new products, like new Quaker Milk Chillers and Tropicana Fruit Integrity, which delivers a fruit serving in a new, fun snack format. These products are mostly incremental, and we've centralized our research and development for this kind of innovation so we can put our resources into developing really big ideas.

Our goal is to incorporate more Type B and Type C innovation into our pipeline. In this way, we may have fewer new products every year, but more of our new product revenues will be incremental. This has already been happening at Frito-Lay, with products like Lay's Stax potato crisps.

On the beverage side, we are finding that "in-and-out" products — those with limited time availability — can create a lot of excitement and incremental volume over a set time period. These products are relatively easy to develop, and we work closely with our bottling partners on the right timing. For example, in 2004, we introduced Mountain Dew Pitch Black just as Mountain Dew LiveWire was winding down. Then, we introduced Pepsi Holiday Spice for the year-end holiday season. These all contribute to differentiating our brands.

## You talked about innovation in terms of brands. Are you innovating in other ways?



\* See page 88

\*\* See page 62

We're innovating in ways that go beyond traditional brand ideas. For example, we look at health and wellness as an opportunity to be an active part of the solution. We've improved the healthfulness of our existing products by tak-

ing important steps like eliminating trans fats in our Frito-Lay chips, reducing saturated fats in Walkers crisps and reducing sugar in some food and beverage products in the United States and other markets. We've also developed new products that deliver more powerful health benefits, like Quaker Take Heart Oatmeal, which can help reduce cholesterol and help maintain healthy blood pressure — two important factors for heart health. The Tropicana Pure Premium line of fortified orange juices is another great example. And we strengthened the Quaker snack line with products like new soy crisps, and new or improved bar products.

In 2005, we'll grow our beverage portfolio with innovation in diet carbonated soft drinks. We'll also add a new line of Gatorade Endurance Formula and Aquafina flavored waters in carbonated and non-carbonated varieties. With snacks, we're relaunching Light versions of our chips with reduced calories and fat.

As an umbrella logo that applies to more than 100 products in our portfolio, we've developed a new Smart Spot trademark in the United States and Canada. The Smart Spot symbol helps consumers find our products that can contribute to healthier lifestyles. The Smart Spot program is based on authoritative statements from the U.S. Food and Drug Administration (FDA) and the National Academy of Sciences (NAS).

Smart Spot products are the fastest growing part of our North American product portfolio, with revenue growth approximately double that of our fun-for-you products. This strategic marketplace solution exists at the intersection of public interest and business interests, and we intend to continue capturing growth through health and wellness solutions that address energy balance.

## You've said PepsiCo's health and wellness initiatives are based on the concept of "energy balance." What do you mean by this?

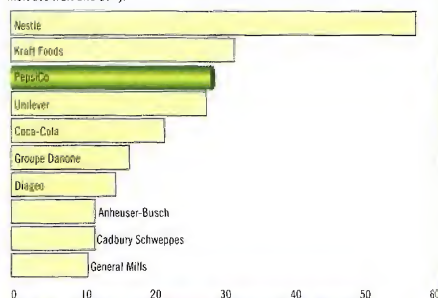
Energy balance challenges consumers to look at calories consumed, as well as calories burned, through physical activity and exercise. We're investing in solutions that address both. We've committed to achieving more than half of our new product revenues from Smart Spot products in North America, and our projections show we'll significantly surpass that goal. We're also stepping up efforts in our new product pipeline to capture this opportunity in markets around the world.

On the physical activity front, we believe we can be part of the solution as well. For example, we're the national presenting sponsor for America on the Move, a national initiative designed to help Americans achieve energy balance by taking 2,000 more steps a day and reducing calories by 100 each day. It's been proven to work, and can help almost anyone get started making simple changes to achieve a healthier lifestyle. We're also funding other efforts that range from activity-based initiatives with the YMCA, to research-based programming, like the partnership Gatorade has with the University of North Carolina's School of Public Health to understand what can help prevent childhood obesity.

### Top Branded Food and Beverage Manufacturers

\$ Net Sales in Billions

Food and Beverage sales. Excludes food ingredients, pet and agricultural products. Includes fruit and dairy.



PepsiCo is the world's third largest food and beverage company.

### Largest PepsiCo Brands

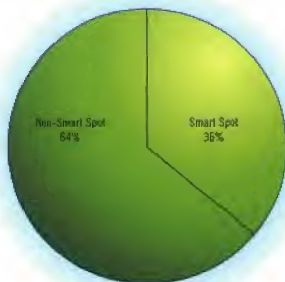
Estimated Worldwide Retail Sales \$ in Billions



PepsiCo has 16 powerful brands that are known around the world and that each generate annual retail sales of more than \$1 billion.

### PepsiCo North America Revenues from Smart Spot Portfolio

% System Revenue



A wide variety of PepsiCo products carry the Smart Spot logo to identify choices that can contribute to healthier lifestyles.

### With the emphasis on Smart Spot, how will you balance investments in the larger, fun-for-you portfolio?

Our goal is to offer a balanced and broad PepsiCo portfolio with a range of great-tasting product choices. While our better-for-you product portfolio is growing at an impressive clip, we also know that it's critical to drive growth in our flagship, heritage brands that comprise our fun-for-you portfolio. For example, within Frito-Lay's core salty portfolio, we focused on Tostitos with an entirely new logo and packaging, and an aggressive "on-shelf" strategy to drive visibility and growth for this venerable billion-dollar brand. We're improving Doritos Nacho Cheesier tortilla chips and making Doritos Black Pepper Jack tortilla chips a permanent addition to our line. On the beverage side of the business, we have aggressive plans for our trademark Pepsi, Mountain Dew and Sierra Mist brands that demonstrate we remain committed to growing these larger, legacy businesses as well.

### In the past, you've talked about the power of Frito-Lay's direct-store-delivery (DSD) system differentiating Frito-Lay in the marketplace. Now, you seem to be taking a new approach with a 50% increase in media spending that is being partially funded by the plant consolidations. Is there a change in strategy?

Frito-Lay's well-known brands feature great taste and really appeal to consumers. The power of the company's virtually unrivaled distribution system has enabled us to differentiate these products in the marketplace, and rely to a lesser extent on high-impact marketing and advertising.

With an explosion of convenient foods choices in the categories where Frito-Lay competes, we need to communicate even more aggressively to strengthen our bond with consumers and highlight our choices for snacking occasions in order to continue growing our top line.

### Historically, there has been a focus on your North America business. How does the international market figure into your growth targets?

The growth and expansion of our international businesses are vital. PepsiCo International became our largest division — by revenues — in 2004. While the year was extraordinary, for the longer term we believe that we can grow our international business at about twice the rate of growth for the United States into the foreseeable future.

We're confident because we have clear leadership of the global snack category, and significantly lower per capita consumption outside the United States. Our volumes are increasing in every region, and we're demonstrating we can capture opportunities by customizing our snack products to meet local tastes and packaging preferences. For example, in Thailand, we've introduced Nori Seaweed Lay's potato chips, and in China, we've captured new "office snacking" opportunities through a new pull-out tray with Lay's Stax potato crisps.

On the beverage side, we have a disciplined, focused growth strategy that includes carbonated and non-carbonated brands. We've introduced flavor innovations tailored to our markets,

new consumer-friendly packaging, and enjoyed great success with high-impact advertising and music and sports marketing.

Overlaying our flexible portfolio, we have global productivity programs in ever increasing scale, and a diverse, talented and experienced team from the front line to senior management. All these elements combine to give us great confidence in our international business and its ability to fire on all cylinders.

***Returning to the question about sustainable growth, you included powerful go-to-market systems as a competitive advantage. What do you mean?***

PepsiCo arguably has the most diverse set of distribution systems of any consumer product company, including direct store delivery (DSD) at Frito-Lay and our bottling partners, warehouse delivery for Quaker products, and warehouse delivery and chilled DSD at Tropicana.

The reach and scale of these systems provide considerable cost efficiency and system effectiveness in driving value.

Our systems deliver product freshness and quality for the consumer, generate cash flow for our retail customers, and provide economic value for PepsiCo. Our products respond very well to merchandising, and need to be replenished often because they sell so quickly. By having our DSD associates deliver products and stock the shelves themselves, we save retailers money by doing this labor for them, and help make sure our products are fresh, available and displayed to our advantage.

***You've referenced PepsiCo's Power of One as a competitive capability. Can you provide some examples of the advantages that Power of One offers retailers?***

Our Power of One really speaks to our ability to use all of PepsiCo's products, services and talents for the advantage of our retail partners. Whether it's a joint promotion between Pepsi and Frito-Lay for Super Bowl Sunday, a "breakfast bundling" opportunity with Quaker and Tropicana brands, creating a shared service unit to support our businesses in Mexico or combining our products that contribute to healthier lifestyles under the Smart Spot banner, the idea is to combine the strength of our brands and businesses to develop customized solutions for customers. This, in turn, drives incremental growth for them, and for us.

We view this as a key strategic growth driver, and will continue to invest in such things as integrated customer teams, research into consumer insights, and creating customized retail solutions to drive growth.

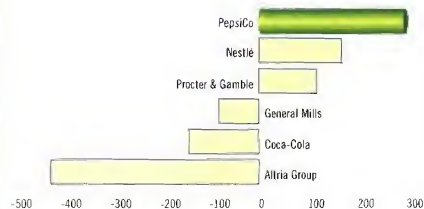
***Retail volume growth seems to be slowing in some channels, such as supermarkets, and accelerating in large-format and discount channels. How is that trend affecting PepsiCo?***

It's obviously important for us to be well-represented in all channels. Like all consumer product companies, we have benefited from the growth of mass merchandisers, clubs and dollar stores. At the same time, we're just as committed to working closely with our supermarket partners to help them grow.

The consolidation of retailers has made our Power of One initiative increasingly important. We can approach these

#### Top Contributors to U.S. Supermarket Growth

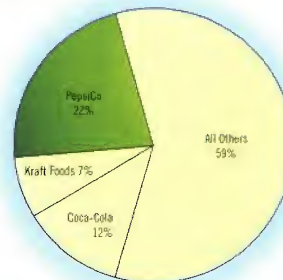
\$ Retail Sales in Millions 2002-2004  
Largest Companies



Among the companies selling the most to supermarkets, PepsiCo products contributed more sales growth than all five of our next largest competitors.

#### U.S. Convenient Food and Beverage Sales

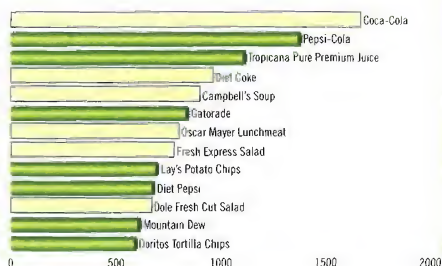
% Total Dollar Sales



PepsiCo is the leading convenient food and beverage company in the United States.

#### Largest Food Brands in U.S. Supermarkets

Estimated \$ Retail Sales in Millions. Excludes alcoholic beverages.



Seven PepsiCo brands rank among the best-selling food and beverage brands in U.S. supermarkets. No other company comes close.



## Business Process Transformation (BPT)

The goal of BPT is to make it easier than ever to do business with PepsiCo — for our retail customers, our suppliers and ultimately the consumers who take our products home with them. To do this, we need to link our business, people and information more closely within PepsiCo.

### Benefits of BPT

We are focusing on several key areas that will benefit from BPT:

- **Customer Insights** — We'll collect better strategic, behavioral and marketing insights to boost growth and sales.
- **Procurement** — We'll grow revenues and reduce costs by optimizing purchasing and ensuring our products are always available.
- **Supply Chain to Distribution** — We'll move PepsiCo's unique delivery capabilities to a new level as we move products faster and less expensively than ever from manufacturing facilities to retail outlets.
- **Finance** — We'll provide faster and more targeted response to the market and our customers through more responsive financial data systems and processes fueled by a single, real-time accessible database that spans across our divisions.
- **Operations** — By better linking our people, our internal operations, our data and our information, we'll be able to respond faster and share needed information more rapidly.

### Why is BPT Needed?

PepsiCo has undergone tremendous change over the past few years. Tropicana Products, The Quaker Oats Company, including Gatorade, and SoBe beverages have joined the PepsiCo family. These companies came with their own processes and systems. For example, each had a different way to bill the same retailer. As a result, customers receive multiple invoices, causing them duplicate effort and increasing complexity. BPT will consolidate our billing.

The marketplace has been evolving as well. Retailers are consolidating, placing growing demands on manufacturers to provide greater efficiency and value. Consumer preferences change overnight and there is a growing interest in a wider variety of products. Meeting these needs demands fast and seamless systems to secure the raw materials we need, manufacture the right amount of products and distribute them quickly and efficiently.

When finished, BPT will simplify and improve our processes. The result will be a PepsiCo that makes it:

- Easier for our customers to work with us.
- Easier for our employees to work together.

And those results can enable stronger performance.

retailers as a powerful partner in supporting their growth objectives. Ultimately, we need to ensure that we have the right products, package sizes, and price points in each channel so that we can maximize growth in each.

Pricing is a key element of our mix. Consumers demand value, which especially means low prices, so we can't depend on price increases for revenue growth. That's why our focus on innovation, commitment to improving product mix, and the priority on delivering customized retail solutions are key to the growth of PepsiCo and our retail customers.

### ***How do you ensure you can deliver on all the priorities required by brand and product investment, and go-to-market systems?***

In a word, it's about people — our ultimate and truest source of competitive advantage. We continue to invest in our people as well.

One of the strengths Wall Street has noticed about PepsiCo is our ability to grow talent from within the company — particularly bench strength for our most senior team. I think this reflects a number of our "people priorities."

For starters, we're passionate about developing leaders. That's why we provide the training, tools and experiences that give us many options when it comes to preparing leaders for tomorrow. But developing this kind of bench strength demands a comprehensive view of people.

That's why we have a focus on diversity and inclusion as a strategic lever to drive the business. As a leading consumer products company, we strive to recruit a diverse workforce to assist us in serving our diverse consumer base. That's diversity. Equally important, we must ensure we're creating and sustaining an environment that allows everyone to contribute at his or her maximum potential in order for the best ideas to come forward — and that's inclusion.

We hold our leaders accountable — and reward them — on their ability to create and sustain a diverse and inclusive workforce at PepsiCo. We're seeing progress. In the last two years, we've put 11,000 associates through a first level of diversity and inclusion training and more than 6,000 associates through a second level of inclusion training. Our ongoing internal measurement of how associates observe diverse and inclusive behavior in management shows we're moving the dial as well.

I know that our 2004 growth benefited from our diversity and inclusion efforts. Product flavor ideas, promotions and advertising benefited from the views of the entire spectrum of our associates. Our successes reinforce that we are on the right track, and we remain committed to this strategic priority as a key growth driver. We know that diversity and inclusion is a journey — in fact, a marathon — and we'll continue investing in the journey to reap its utmost benefits.

### ***With your focus on diversity and inclusion, brand building, and go-to-market capabilities, how will you fund everything?***

Some of the investment comes from top-line growth, and some of it comes from productivity initiatives around the world.

Whether in supply chain manufacturing, procurement of goods and services, or more efficient trade and media spending, at any given time PepsiCo has hundreds of productivity programs under way.

We view these efforts to control costs as critical fuel for brand building and innovation work, which leads to top-line growth that we can use to fund further productivity projects. That's the value creation cycle I mentioned earlier, and it provides flexibility for us to meet our stated double-digit earnings goals. At the same time, it allows us to return cash to shareholders through our share buy back program and dividend payments, which PepsiCo's Board of Directors increased by 44% in 2004.

### **What is "Business Process Transformation" (BPT) and how does it contribute to the business?**

Business Process Transformation (BPT) is the comprehensive effort to drive efficiencies at PepsiCo, and fuel our future growth. It includes efforts to physically consolidate, or hardwire, key business functions to take advantage of our scale. It also includes moving to a common set of processes that underlie our key activities, and supporting these activities with common technology applications. And finally, it's about linking our systems so that data will flow seamlessly from system to system. Our SAP installation — the computer system that will link all of PepsiCo's systems and processes — is the linchpin for these efforts. A special project team has started implementing this multi-year BPT effort.

While obviously requiring funding, this is exactly the kind of initiative which is designed to yield efficiencies that we can reinvest back into our business for many years to come.

Once BPT is fully implemented, we'll have flexibility in everything we do. We'll be able to more easily change any product through better control of our supply chain. We'll have even greater accuracy in our operations, removing the need for checking and rechecking. We'll also achieve efficiencies and consistency by delivering lower costs through common processes and expanded IT capabilities, delivered through one face to the customer. We'll have end-to-end, real-time visibility to data that allows us to use information as a true strategic tool. And finally, with a common IT platform, we'll be able to more quickly expand to take on new businesses seamlessly.

### **PepsiCo has a lot to accomplish. How do you balance current and future needs without compromising anything?**

Here again, it ultimately comes down to people and the values they hold. In last year's annual report, our theme was "Growth and Trust." We emphasized the importance of growth in the right way — as a responsible corporate citizen. Our focus remains centered on behaving in this way.

For example, we continue to make progress with our efforts in environmental management and sustainability. I encourage shareholders, once again, to read the Corporate Social Responsibility Report in this publication. But it's also

important to understand that we continue to spend a considerable amount of time and energy reinforcing the PepsiCo Values that will get us growth the right way for our future. We remain steadfast in our commitment to sustained growth, through empowered people, acting with responsibility and building trust.

When you think about it, we're lining up what we do best and investing in those capabilities to drive value today and into our future. And we're doing it in a responsible way. Our shareholders demand this kind of responsible growth and should expect nothing less, just like all of us at PepsiCo.



**Steve S Reinemund**  
Chairman and Chief Executive Officer

## **A Word of Thanks**

### **Al Bru**

In September 2004, we announced that Al Bru, chairman and chief executive officer of Frito-Lay North America, would retire after 28 years of service. Having led the division since 1999 and previously run the salty snack and confectionery Sabritas business in Mexico, Al stayed on as PepsiCo vice chairman until February 2005.

Al led two of PepsiCo's largest and most dynamic divisions. He built a strong portfolio of brands in Mexico, and went on to generate strong volume, profit and share growth at Frito-Lay in North America. An active leader of our Latino/Hispanic Advisory Board, Al has continuously represented PepsiCo in the community. He has been a tremendous inspiration to me and many others who appreciate his expertise, insights and friendship. Al has a passion for PepsiCo, and we've been fortunate to have a leader of his caliber for so many years.

On behalf of the entire PepsiCo family, I extend our sincere thanks to Al for a lifetime of extraordinary service.

### **Frank Raines**

We also say goodbye to Frank Raines, who has announced he will not stand for reelection to our Board of Directors in 2005. Frank has been an active director and chaired our Audit Committee. As a result of his leadership, we're well positioned to meet the ever changing demands of our business. We were fortunate to have his contributions. He was elected to the board in 1999, and was re-elected by an overwhelming majority of our shareholders each year since. We will miss his sage advice and counsel.

-SSR

# Frito-Lay North America (FLNA)

## U.S. Category Leaders



Frito-Lay North America demonstrated the strength of our industry-leading brands, powerful innovation pipeline and flexible go-to-market systems, as FLNA delivered another year of remarkable performance and set the stage for future growth.

## Muscular Brands

FLNA is the leader in major categories where we compete — potato chips with Lay's and Ruffles; tortilla chips with Tostitos and

Doritos; extruded snacks with Cheetos; corn chips with

Fritos; multigrain chips with Sun Chips; and pretzels with

Rold Gold. And with a broad portfolio of products

— including everything from chips and granola bars to

dips, salsas, nuts and seeds — we appeal to a wide range of

consumer tastes. Building on the

strength of our brands, we introduce line extensions and limited time available products that provide variety for current

consumers and appeal to new consumers. In fact, Doritos Black Pepper

Jack tortilla chips, introduced as a limited time available product, was so

popular we made it permanent.

## Innovative Products

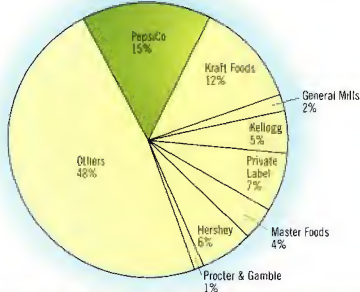
We continue to drive growth of Lay's potato chips, our biggest trademark. Responding to consumer preferences, we made America's No. 1 potato chip even crispier through an improvement in our proprietary cooking process.

(Continued on page 10)

## U.S. Convenient Foods Industry Sales

% Retail Sales

Includes chips, pretzels, ready-to-eat popcorn, crackers, dips, snack nuts/seeds, meat snacks, yogurt, bars, cookies, candy, pastry, sweet, and other snacks.



Frito-Lay has the leading share of the snack food business in the United States.

## Advantage: Muscular Brands

Our brands provide the muscle to build our businesses well into the future. PepsiCo's brands are among the largest and best known in the world. Every day, our more than 500 products are purchased by millions of consumers. Sixteen of our brands each sell more than a billion dollars annually at retail.



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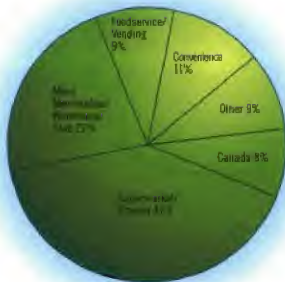


Drink.

Drink.

### U.S. Frito-Lay North America Distribution Channels

% Volume



The Frito-Lay North America distribution system serves some 436,000 retail outlets weekly.

Following these moves, we hit the road with the Lay's Challenge, which invited consumers across the country to try Lay's chips and taste the improvement. We expanded our Lay's Stax potato crisp line to include Salt and Vinegar as well as Monterrey Pepper Jack flavors. We also expanded our Natural line of snacks to include Doritos Natural tortilla chips in Cool Ranch and White Nacho Cheese flavors.

Packaging innovations drove growth in our Tostitos line. We re-launched our full line of Tostitos tortilla chips and salsas with a new logo and new blue packaging that stands out on store shelves, creating a consistent look across the entire line. To better inform consumers about our increased focus on

health and wellness, we added the "0 grams trans fat" message on the front of packaging for Lay's, Doritos, Tostitos, Cheetos, Ruffles and Fritos, following our move in 2003 to become the first U.S. food company to remove trans fat from our salty snack products.

Plenty of our innovation is focused on health and wellness. We added to our Baked! reduced-fat product line with Baked! Cheetos snacks. Anticipating the role whole grains would play in new dietary recommendations, we added a heart healthy message to Sun Chips, our multigrain line of snack chips. We launched Munchies "Kids Mix" variety, which is fortified with eight essential vitamins and minerals. We also restaged our "WOW!" chips — our line of snacks cooked in olestra — as the "Light" line of Lay's, Ruffles, Doritos and Tostitos to more effectively communicate the products' reduced calories and fat.

### Powerful Go-To-Market Systems

Our Direct Store Delivery System — the cornerstone of our competitive advantage in the market — continues to fuel our growth. This system, in which we deliver products directly to retailers, allows us to respond quickly to the marketplace and tailor our marketing and merchandising. Our DSD system benefited from an investment in people and processes for enhanced performance in the marketplace. Our go-to-market system also includes warehouse distribution, giving us additional flexibility that helps drive our partnerships with our customers.

## PepsiCo Beverages North America (PBNA)

PepsiCo Beverages North America leveraged our competitive advantages with its powerful trademarks, strong innovation pipeline, and flexible go-to-market systems to achieve another year of outstanding growth in 2004.

### Muscular Brands

PBNA is the No. 1 liquid refreshment beverage company in measured channels. We are the only company with three major trademarks in carbonated soft drinks — Pepsi, Mountain Dew and Sierra Mist. And when it comes to non-carbonated soft drinks, we have the No. 1 equities across nearly every category — Gatorade in sports drinks; Aquafina in water; Tropicana and Dole in chilled juices and juice drinks; Lipton in ready-to-drink teas; Propel in enhanced water, and Frappuccino in ready-to-drink coffee.

### Innovative Products

As consumers increasingly focus on health and wellness, these powerful trademarks put us in an exceptional position to respond. Tropicana is among the top brands in nutrition; Gatorade leads in functional beverages and we also have an unmatched portfolio of zero-calorie products, with brands such as Diet Pepsi and Aquafina. In 2004, we increased our Diet Pepsi advertising and promotions, using the tagline, "Diet Pepsi: It's the Diet Cola" to illustrate that it is a great choice to go with food and social occasions. We changed the name of Diet Sierra Mist to Sierra Mist Free to help consumers identify it as free of sugar, calories, carbohydrates and caffeine. We supported Sierra Mist Free — the fastest-growing zero-calorie lemon-lime drink in the United States

— with a comprehensive marketing campaign. Our new campaign for Aquafina encouraged consumers to “Drink More Water,” recognizing people’s desire to drink more water for health benefits and taking advantage of our position as the market leader in bottled water.

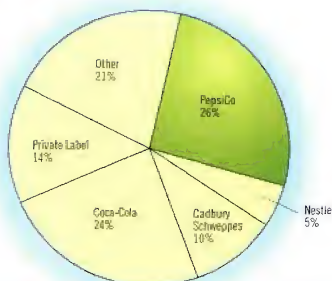
We helped meet consumers’ growing focus on nutrition with a robust innovation pipeline. We took our Tropicana Pure Premium orange juice line, already a quintessential healthy breakfast staple, to a new level of wellness benefits by launching Tropicana Essentials juices. This sub-line of fortified orange juice and juice beverage products serves a variety of individual consumer needs — from less sugar and fewer calories to more vitamins and minerals. The sub-line is headlined by Tropicana Light’n Healthy juice beverages, which offer half the calories and carbohydrates of orange juice. We also reached consumers looking to reduce their sugar intake with Pepsi Edge, a full-flavored cola with 50% less calories and sugar than regular cola. We also responded with packaging innovation, such as our successful launch of 8-ounce Pepsi cans for consumers who want a convenient way to reduce portion size.

Our vast innovation pipeline helps us create consumer excitement in the soft-drink aisle through several “in-and-out” products — those with limited-time availability. Just as Mountain Dew LiveWire was winding down its second successful summer, we introduced Mountain Dew Pitch Black — combining the great taste of Mountain Dew with a blast of grape flavor — for the Halloween season. Then we introduced Pepsi Holiday Spice — Pepsi-Cola with a spicy finish of ginger and cinnamon — for the year-end holiday season. These products give consumers variety, while at the same time giving our major trademarks — Pepsi and Mountain Dew — an important lift. A new lime-flavored Pepsi and more cherry flavor for Pepsi Wild Cherry are part of the news for 2005.

Innovation fueled our Gatorade thirst quencher business, which continued to achieve double-digit growth. With Gatorade X Factor, we added a new fruity twist to our best-selling flavors — Lemon Lime with Strawberry, Orange with Tropical Fruit and Fruit Punch with Berry — resulting in the brand’s biggest sub-line launch ever. Innovation also took the shape of our redesigned sports bottle that works like a piece of sports equipment. With a powerful innovation agenda for 2005, including an Endurance Hydration Formula and a lemonade flavor sub-line, we believe Gatorade will continue to drive category growth.

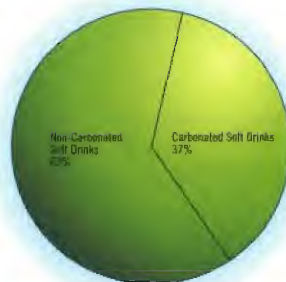
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**U.S. Liquid Refreshment Beverage Market Share**  
% Volume in Measured Channels



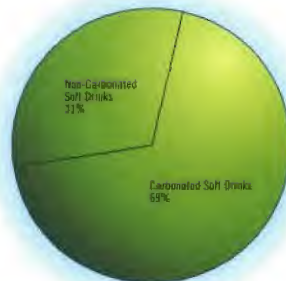
PepsiCo has the leading share of the liquid refreshment beverage market.

**PepsiCo Beverages North America Carbonated Soft Drink Revenue vs Non-Carbonated Soft Drink Revenue**



Non-carbonated soft drinks generate the largest revenue.

**PepsiCo Beverages North America Carbonated Soft Drink Volume vs. Non-Carbonated Soft Drink Volume**



Carbonated beverages generate the largest volumes.

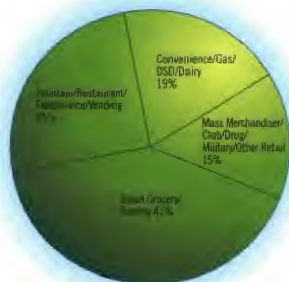




## Advantage: Innovative Products

We create a continuous stream of products and packages to meet consumer needs and create interest in our products. Our new "Smart Spot" symbol marks a new era in helping consumers identify our product choices that can contribute to healthier lifestyles. And we're partnering with America on the Move — an initiative to help people make simple changes in diet and exercise to improve their health — to encourage people to add more activity to their lives.

U.S. PepsiCo Beverage Distribution Channels  
% Volume



PepsiCo beverages are distributed by a powerful go-to-market system that includes company-owned operations and independently-owned franchised bottlers.

## Powerful Go-To-Market Systems

PBNA continues to demonstrate the strength of our four go-to-market systems: bottler direct store delivery, warehouse, chilled direct store delivery and foodservice. We have the No. 1 warehouse delivery system among beverage companies, and we lead with two big brands — Tropicana and Gatorade. Our juice businesses' growth was boosted by the successful launch of the new line of Tropicana juice drinks distributed through our bottling system. Our bottling system is helping to expand Gatorade distribution in places like schools and recreation facilities. We began implementing dedicated broker teams to build the presence of Gatorade and Tropicana in convenience stores and up-and-down the street locations. And we continue to leverage our direct store delivery advantage to drive Aquafina distribution through vending and foodservice channels.

## U.S. Category Leaders



# PepsiCo International (PI)

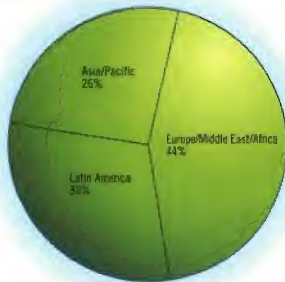
PepsiCo International, which comprises our beverages, snacks and foods businesses outside North America, generated the largest part of our revenues in 2004, driven by our outstanding brands, world-class go-to-market systems and the strength of our people.

## Muscular Brands

PI's portfolio includes well-known brands such as Pepsi-Cola, Walkers, Sabritas, Gamesa, Lay's, 7UP, Gatorade and Tropicana. In 2004, we continued to grow these brands through innovation. Our extension of Walkers — already the No. 1 consumer brand in the United Kingdom — with Walkers Sensations, a line of more indulgent snacks, helped us gain a solid position in the “evening snacking” occasion.

### PepsiCo Beverage Volume Outside North America

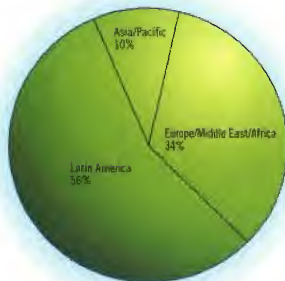
% System Volume by Region  
Includes Pepsi-Cola, Gatorade, Tropicana, 7UP and other beverages sold outside North America.



PepsiCo beverages are available in about 175 countries and are distributed locally by company-owned and franchised bottlers.

### PepsiCo Snack Volume Outside North America

% System Volume by Region



PepsiCo snack brands are distributed in about 170 countries, making PepsiCo the largest salty snack company in the world.

## Innovative Products

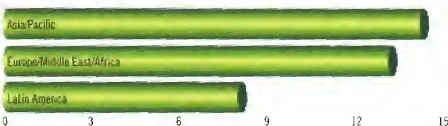
We're growing our leadership position in salty snacks even more by adapting our global brands to local tastes. This kind of innovation is vital, given the wide varieties in foods and eating habits across international markets. In 2004, for example, we made our global Doritos brand more appealing to Turkish consumers with Doritos a la Turca chips, which incorporate sesame or poppy seeds.

The power of packaging innovation is driving growth in categories where convenience is king. We developed a new soft drink package — known as the “grip” bottle — that offers a variety of consumer benefits, such as a contoured, ergonomic design that makes it easier to hold. It is also less costly to produce than the packages it replaced. In addition, we offered packages designed to address consumer affordability in emerging markets, such as the 200 ml. glass bottle in India and the 2.5 liter PET bottle in Mexico.

(Continued on page 16)

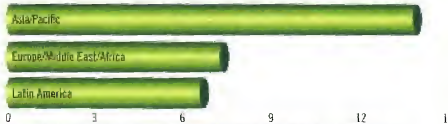
### Beverage Volume Growth by Region

% System Volume Growth



### Snack Volume Growth by Region

% System Volume Growth



PepsiCo International beverages and snacks generated growth across all regions.

## Advantage: Powerful Go-To-Market Systems

PepsiCo's advantaged distribution systems include direct store delivery. Our route salespeople deliver products, stock the shelves, and keep track of what our retail customers need to generate sales and satisfy consumers. This means better service for our customers and consumers, and more sales for us. For example, our Sabritas team in Mexico reaches more than 700,000 retail outlets weekly, including the smallest “changarro.”





## Powerful Go-To-Market Systems

Our international business has powerful go-to-market systems. Our vast Sabritas network, for instance, reaches into nearly every nook and cranny of Mexico, giving us a virtually unmatched distribution reach. This provides us with an extraordinary ability to get new products to market very quickly. And given the system's scale, almost anything we do to improve efficiency yields significant cost savings.

We are using the strength of our organization by bringing together all our businesses — snacks, beverages and foods — under a single leader in several regions — Asia, Europe, the United Kingdom, the Middle East and Africa. This helps us bring leadership scale to some of our smaller businesses. At the same time, it facilitates cooperative efforts between our various PepsiCo businesses in these regions.

## Quaker Foods North America (QFNA)

### Muscular Brands

Quaker Foods North America's powerful portfolio includes valuable trademarks such as Quaker oatmeal, Quaker grits, Life cereal, Cap'n Crunch cereal, Aunt Jemima syrup and pancake mixes, and Rice-A-Roni, Pasta Roni and Near East side dishes. In many categories — including hot cereal, grits and pancake syrups — QFNA is the market leader, and the breadth of its brands brings us to both the breakfast and dinner tables.

### Innovative Products

Building on the nutrition credentials of Quaker — already No. 1 among brands Americans associate with health — we added innovations that deliver healthful benefits. In early 2005, we launched Quaker Take Heart Instant Oatmeal — advanced nutrition for heart health, helping to reduce cholesterol and maintain healthy blood pressure. Our innovation pipeline included Quaker Oatmeal Supreme, with heartier, larger oats in three delicious flavors: banana walnut, cinnamon pecan and apple raisin, and Quaker Lower Sugar Instant Oatmeal, which contains 50% less sugar than regular instant oatmeal. We addressed consumer health in our ready-to-eat cereal business as well, launching Cap'n Crunch's Swirled Berries with one-third less sugar. Other innovation in our ready-to-eat cereal business included our launch of Honey Graham Life, which helped to drive incremental growth.

Our Quaker brand, in combination with Tropicana, provides a remarkable resource as we continue to work to grow our leading share of the breakfast occasion through breakfast bundling events and national promotions.

### U.S. Category Leaders



### Advantage: People

From purchasing to manufacturing to distribution, it's the dedication of PepsiCo people that makes the difference. Quaker Foods North America associates Robin Phillips, operator (foreground), Marlene Campbell, tender (center), and Jean Barnd, team leader (background), have more than 60 years of combined service between them. Our associates create PepsiCo's success.







# Principal Divisions and Corporate Officers

## Executive Offices

### PepsiCo, Inc.

700 Anderson Hill Road  
Purchase, NY 10577  
914-253-2000

## Co-Founder of PepsiCo, Inc.

### Donald M. Kendall

Over 55 years of PepsiCo experience.

## Corporate Officers

### Steven S. Reinemund

Chairman of the Board and  
Chief Executive Officer  
56. 20 years.

### Indra K. Nooyi

President and  
Chief Financial Officer  
49. 11 years.

### Peter A. Bridgman

Senior Vice President and Controller  
52. 19 years.

### Albert P. Carey

President, PepsiCo Sales  
53. 23 years.

### Steven Y. Gold

Senior Vice President,  
Supply Chain  
40. 1 year.

### James Kozlowski

Senior Vice President,  
Global Procurement  
54. 19 years.

### Tod J. MacKenzie

Senior Vice President,  
Corporate Communications  
47. 17 years.

### Matthew M. McKenna

Senior Vice President, Finance  
54. 11 years.

### Margaret D. Moore

Senior Vice President,  
Human Resources  
57. 31 years.

### Lionel L. Nowell, III

Senior Vice President and Treasurer  
50. 5 years.

### Larry D. Thompson

Senior Vice President,  
Government Affairs,  
General Counsel and Secretary  
59. Under 1 year.

## Principal Divisions and Officers

### Frito-Lay North America

7701 Legacy Drive  
Plano, TX 75024  
972-334-7000

### Irene B. Rosenfeld

Chairman and Chief Executive Officer  
51. Under 1 year.

### PepsiCo Beverages & Foods North America

555 West Monroe Street  
Chicago, IL 60661  
312-821-1000

### Gary M. Rodkin

Chairman and Chief Executive Officer  
52. 9 years.

### PepsiCo International

700 Anderson Hill Road  
Purchase, NY 10577  
914-253-2000

### Michael D. White

Chairman and Chief Executive Officer  
53. 15 years.



# PepsiCo Board of Directors



Top row, left to right: Robert E. Allen, John F. Akers, Steven S Reinemund, Indra K. Nooyi, Franklin A. Thomas, James J. Schiro, Sharon Percy Rockefeller.  
Bottom row, left to right: Franklin D. Raines, Solomon D. Trujillo, Ray L. Hunt, Cynthia M. Trudell, Arthur C. Martinez, Daniel Vasella.

## **John F. Akers**

Former Chairman of the Board and Chief Executive Officer, International Business Machines  
70. Elected 1991.

## **Robert E. Allen**

Former Chairman of the Board and Chief Executive Officer, AT&T Corp.  
70. Elected 1990.

## **Ray L. Hunt**

Chief Executive Officer  
Hunt Oil Company and Chairman, Chief Executive Officer and President, Hunt Consolidated, Inc.  
61. Elected 1996.

## **Arthur C. Martinez**

Former Chairman of the Board, President and Chief Executive Officer, Sears, Roebuck and Co.  
65. Elected 1999.

## **Indra K. Nooyi**

President and Chief Financial Officer, PepsiCo  
49. Elected 2001.

## **Franklin D. Raines**

Former Chairman of the Board and Chief Executive Officer, Fannie Mae  
56. Elected 1999.

## **Steven S Reinemund**

Chairman of the Board and Chief Executive Officer, PepsiCo  
56. Elected 1996.

## **Sharon Percy Rockefeller**

President and Chief Executive Officer, WETA Public Stations, Washington DC  
60. Elected 1986.

## **James J. Schiro**

Chief Executive Officer, Zurich Financial Services  
59. Elected 2003.

## **Franklin A. Thomas**

Consultant, TFF Study Group  
70. Elected 1994.

## **Cynthia M. Trudell**

President, Sea Ray Group  
51. Elected 2000.

## **Solomon D. Trujillo**

Former Chief Executive Officer, Orange SA  
53. Elected 2000.

## **Daniel Vasella**

Chairman of the Board and Chief Executive Officer, Novartis AG  
51. Elected 2002.

Listings include age and year elected PepsiCo director.

# Advisory Boards

*To provide additional competitive advantage, we seek the views of individuals who can provide expertise and unique perspectives. We've created three Advisory Boards to actively consult on key aspects of our business.*

## Ethnic Advisory Boards

Our Ethnic Advisory Boards provide management with external viewpoints on issues related to diversity and inclusion, especially in the marketplace.

Individuals are chosen based on their diverse backgrounds, experiences and points of view. These boards provide counsel and advice on a range of business areas including:

## African American Advisory Board



Left to right:  
Johnnie L. Cochran, Esq.,  
Reverend Dr. Franklyn  
Richardson,  
Reverend Al Sharpton,  
Clarence Avant,  
Keith Clinkscales,  
Amy Hilliard,  
Warren M. Thompson,  
Glenda McNeal,  
Robert Holland,  
Earl G. Graves, Sr.,  
Darlene Williamson, Ph.D.,  
Dawn Hudson,  
Johnny F. Johnson,  
Jerri DeVard,  
Gary Rodkin,  
Darwin N. Davis, Sr.,  
Benaree Pratt Wiley,  
Ray M. Robinson.

**Clarence Avant**  
Chairman,  
Interior Music  
Joined 1999.

**Keith Clinkscales**  
President,  
KTC Ventures  
Joined 1999.

**Johnnie L. Cochran, Esq.**  
Partner,  
Cochran, Cherry, Givens,  
Smith & Ferrer  
Joined 1999.

**Darwin N. Davis, Sr.**  
Consultant,  
Retired Senior Vice President,  
AXA/Equitable  
Joined 1999.

**Jerri DeVard**  
Senior Vice President,  
Brand Management and  
Marketing Communications,  
Verizon Communications  
Joined 2002.

**Earl G. Graves, Sr.**  
Chairman and Chief  
Executive Officer,  
Earl G. Graves Ltd.  
Joined 1999.  
Chairman of the  
Advisory Board

**Amy Hilliard**  
President and Chief  
Executive Officer,  
The Hilliard Group &  
The ComfortCake Co.  
Joined 1999.

**Robert Holland**  
Partner, Williams Capital  
Joined 1999.

**Dawn Hudson**  
President,  
Pepsi-Cola North America  
Joined 1999.

**Johnny F. Johnson**  
Chairman and Chief  
Executive Officer,  
Market Place Holdings, Inc.  
Joined 1999.

**Glenda McNeal**  
Senior Vice President  
Global Partnership,  
American Express  
Joined 1999.

**Reverend Dr. Franklyn  
Richardson**  
Senior Minister,  
Grace Baptist Church  
Joined 1999.

**Ray M. Robinson**  
President,  
East Lake Golf  
Joined 1999.

**Gary Rodkin**  
Chairman and Chief  
Executive Officer,  
PepsiCo Beverages & Foods  
Joined 1999.

**Reverend Al Sharpton**  
President, National  
Action Network  
Joined 1999.

**Warren M. Thompson**  
President/Chairman,  
Thompson Hospitality  
Corporation, Inc.  
Joined 2002.

**Benaree Pratt Wiley**  
President and Chief  
Executive Officer,  
The Partnership  
Joined 2002.

**Darlene Williamson, Ph.D.**  
President and Chief  
Executive Officer,  
Performax Consulting  
Services  
Joined 1999.



- Marketing to ethnic communities.
- Creating alliances with ethnic retailers.
- Creating products for ethnic consumers.
- Developing a diverse supplier base and other business relationships.
- Promoting PepsiCo's diversity and inclusion efforts.
- Hiring, retaining and motivating diverse employees.

- Expanding diversity representation among PepsiCo employees.
- Providing a perspective on diversity and inclusion issues or questions.

Our African American Advisory Board was formed in 1999. The Latino/Hispanic Advisory Board was established in 2000.

## Latino/Hispanic Advisory Board



Left to right:  
Gilbert Aranza,  
Carlos A. Saladrigas,  
Isabel Valdés,  
Irene Rosenfeld,  
Victor Arias, Jr.,  
Dr. Douglas X. Patiño,  
Abelardo E. Bru,  
John Compton,  
Raúl Yzaguirre,  
Dr. Carlos H. Arce,  
Raquel Malo,  
Dr. Ricardo R. Fernández,  
Deborah Rosado Shaw.

**Gilbert Aranza**  
President, Star Concessions  
The MultiRestaurant Group  
Joined 2000.

**Dr. Carlos H. Arce**  
President and Founder,  
NuStats  
Joined 2000.

**Victor Arias, Jr.**  
Partner,  
Heidrick & Struggles  
Joined 2000.

**Abelardo E. Bru**  
Former Chairman and Chief  
Executive Officer,  
Frito-Lay North America  
Joined 2000.

**John Compton**  
Vice Chairman,  
Frito-Lay North America  
Joined 2000.

**Dr. Ricardo R. Fernández**  
President, Lehman College,  
The City University of  
New York  
Joined 2003.

**Raquel Malo**  
Director, High  
Performance Nutrition  
LGE Performance  
Systems, Inc.  
Joined 2004.

**Dr. Douglas X. Patiño**  
Vice Chancellor Emeritus  
and Professor,  
California State University  
Joined 2000.

**Irene Rosenfeld**  
Chairman and Chief  
Executive Officer,  
Frito-Lay North America  
Joined 2004.

**Carlos A. Saladrigas**  
Chairman,  
Premier American Bank  
Joined 2003.

**Deborah Rosado Shaw**  
Chief Executive Officer,  
Umbrellas Plus, LLC  
Joined 2000.

**Isabel Valdés**  
Consultant, Author, Public  
Speaker  
Joined 2001.

**Raúl Yzaguirre**  
Former President and Chief  
Executive Officer,  
National Council of La Raza  
Joined 2000.  
Chairman of the  
Advisory Board

## Health and Wellness Advisory Board

PepsiCo formed a Blue Ribbon Health and Wellness Advisory Board in 2003 to address the growing opportunity in health and wellness. The Board provides advice and expertise on a variety of health and wellness initiatives including:

- Improving the healthfulness of our existing products.
- Developing new better-for-you and good-for-you products.

- Providing access to resources that promote health and encourage active lifestyles.
- Identifying emerging opportunities in the area of health and wellness.
- Connecting us to thought leaders and policy makers in the area of health and wellness.



Front row, left to right:  
Gro Brundtland, M.D.,  
Antonia Demas, Ph.D.,  
David Heber, M.D., Ph.D.,  
Dean Ornish, M.D.,  
Samuel Ward Casscells, III, M.D.,  
Brock Leach,  
Susan Love, M.D.

Second row, left to right:  
Janet Taylor, M.D.,  
James Hill, Ph.D.

Back row, left to right:  
Kenneth Cooper, M.D., M.P.H.,  
Mario Maranhão, M.D.,  
George Graham, Ph.D.,  
Pamela Peeke, M.D., M.P.H.,  
Fernando Trevino, Ph.D., M.P.H.,  
Kenneth Gladish, Ph.D.,  
David Kessler, M.D., J.D.,  
Ambassador Thomas S. Foley,  
Governor James B. Hunt, Jr.

**Gro Brundtland, M.D.**  
Former Director General,  
World Health Organization,  
United Nations,  
Former Prime Minister, Norway

**Samuel Ward Casscells, III, M.D.**  
John Edward Tyson  
Distinguished Professor of  
Medicine & Public Health and  
Vice President for Biotechnology,  
University of Texas Health &  
Science Center at Houston

**Kenneth Cooper, M.D., M.P.H.**  
President and Founder,  
The Cooper Aerobics Center

**Antonia Demas, Ph.D.**  
Director, Food Studies Institute

**Ambassador Thomas S. Foley**  
Partner,  
Akin, Gump, Strauss, Hauer &  
Feld, LLP, Former Speaker of  
the U.S. House of  
Representatives and Former  
U.S. Ambassador to Japan

**Kenneth Gladish, Ph.D.**  
National Executive Director,  
YMCA of the USA

**George Graham, Ph.D.**  
Chairman, Department of  
Kinesiology, Pennsylvania State  
University

**David Heber, M.D., Ph.D.**  
Professor of Medicine & Public  
Health Director, UCLA Center for  
Human Nutrition

**James Hill, Ph.D.**  
Professor of Pediatrics &  
Medicine,  
University of Colorado Health  
Sciences Center,  
Founder, America on the Move™

**Governor James B. Hunt, Jr.**  
Attorney, Womble Carlyle  
Sandridge & Rice,  
Former Governor of  
North Carolina

**David Kessler, M.D., J.D.**  
Dean, School of Medicine,  
Vice Chancellor for  
Medical Affairs,  
University of California,  
San Francisco

**Brock Leach**  
Senior Vice President, New  
Growth Platforms and Chief  
Innovation Officer,  
PepsiCo

**Susan Love, M.D.**  
Professor of Surgery, The David  
Geffen School of Medicine at  
UCLA and Founder of  
Lluminari, multimedia women's  
health company

**Mario Maranhão, M.D.**  
Immediate Past-President,  
World Heart Federation,  
Professor of Cardiology,  
Evangelical School of Medicine  
and Hospital

**Dean Ornish, M.D.**  
Founder and Director,  
Preventive Medicine  
Research Institute,  
Chairman of the Advisory Board

**Pamela Peeke, M.D., M.P.H.**  
Assistant Professor, University  
of Maryland School of Medicine,  
Expert and speaker in nutrition,  
stress and integrative medicine

**Janet E. Taylor, M.D.**  
Clinical Instructor, Pediatric  
Psychiatry, Harlem Hospital,  
President/CEO, Mind Projects,  
Inc., Lluminari Expert Network

**Fernando Trevino, Ph.D., M.P.H.**  
Dean, School of Public Health  
University of North Texas,  
Past President, World  
Federation of Public  
Health Associations,  
Former Executive Director,  
American Public Health  
Association

# A Look at Our Corporate Citizenship

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#### Report Boundaries

This report covers 2004 and primarily presents information for our North American operations. Information for our international operations is provided where indicated. The last report was 2003.



# Vision and Strategy

## Letter from the Chairman

### Dear Friends,

I'm pleased to share our second corporate responsibility report. We've made real progress during the past year. More than ever, I'm convinced that our success depends on our ability to build strong and enduring relationships with everyone we touch: associates, shareholders, consumers, retail customers, business partners, suppliers, governments, community members, educational institutions and organizations working to improve our communities, our environment and our lives.

In 2004, we focused on better defining what we aspire to achieve in the realm of corporate citizenship. Early in the year, we established our Sustainability Task Force — comprised of senior executives from all our divisions — to educate ourselves on what sustainability means for PepsiCo, to develop our vision of sustainability and to review our programs, policies and strategies. Our single goal was to ensure PepsiCo is a sustainable company in every sense of the word. Also in 2004, we joined the World Business Council for Sustainable Development (WBCSD).

For PepsiCo, the meaning of sustainability all came to a simple sentence. It is a vision we will be proud to live by. It is purposeful, concise, memorable and employs the symbol ">" to signify "more or better than." Our goal in everything we do is to make "Tomorrow better than Today."

In addition to defining our sustainability vision, we began the process of reviewing our programs and processes. This is an ongoing journey, and we will share our progress with you each year as we report using the Global Reporting Initiative (GRI) guidelines. The GRI provides a template for reporting on our triple bottom line: our company's economic, environmental and social performance. This year, we have increased the number of indicators on which we are reporting, and we've increased the depth of that reporting as well. While the report primarily covers the United States and is still far from complete, it represents significant progress for us. An index to the GRI is provided in this report, as well as on-line at our corporate website (<http://www.pepsico.com>), where more information about our sustainability efforts can be found.

We continue to focus on the five areas we've defined as critical to our success:

1. **Values** — We view our corporate values as an integral part of our approach to sustainability.
2. **Diversity and Inclusion** — We are focused on building the diverse workforce and inclusive culture that are necessary for our success.
3. **Health and Wellness** — Our health and wellness initiatives, including the new "Smart Spot" symbol, strengthen our commitment to contribute to the well-being of our consumers. Our new HealthRoads Program helps demonstrate our commitment to our associates and their families.
4. **Water** — We are developing additional programs to use this precious resource wisely.
5. **Packaging** — We have a responsibility to help create a cleaner environment and have targeted initiatives in this area.

In addition, we are announcing our new HIV/AIDS policy as well as our report on the work we have begun to help fight this devastating pandemic. You will find information on many other areas in our report and on our website. As the inclusion of this report in our annual financial report demonstrates, we view sustainability as part of the way we do business. I hope you will find this report informative and you will continue to come along with us on our journey towards sustainability. Your comments are welcomed and appreciated.



Steve Reinemund  
Chairman of the Board and  
Chief Executive Officer

### PepsiCo Sustainability Vision

**PepsiCo's responsibility is to continually improve all aspects of the world in which we operate — environment, social, economic — creating a better tomorrow than today.**

## Tomorrow > Today

# Mission, Values and Guiding Principles

## Our Mission

We aspire to make PepsiCo the world's premier consumer products company, focused on convenient foods and beverages. We seek to produce healthy financial rewards for investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. And in everything we do, we strive to act with honesty, openness, fairness and integrity.

The behaviors that will help us achieve our mission are articulated in our Values Statement.

## Our Values

Our commitment is to deliver sustained growth, through empowered people, acting with responsibility and building trust. Here's what this means:

**Sustained Growth** is fundamental to motivating and measuring our success. Our quest for sustained growth stimulates innovation, places a value on results, and helps us understand whether today's actions will contribute to our future. It is about growth of people and company

performance. It prioritizes making a difference and getting things done.

**Empowered People** means we have the freedom to act and think in ways that we feel will get the job done, while being consistent with the processes that ensure proper governance and being mindful of the rest of the company's needs.

**Responsibility and Trust** form the foundation for healthy growth. It's about earning the confidence that other people place in us as individuals and as a company. Our responsibility means we take personal and corporate ownership for all we do, to be good stewards of the resources entrusted to us. We build trust between ourselves and others by walking the talk and being committed to succeeding together.

## Our Guiding Principles

This is how we carry out Our Commitment.

We must always strive to:

**Care for customers, consumers and the world we live in.** We are driven by an intense, competitive spirit in the marketplace, but we direct this spirit toward solutions that achieve

a win for each of our constituents as well as a win for the corporation. Our success depends on a thorough understanding of our customers, consumers and communities. Caring means going the extra mile. Essentially, this is a spirit of growing rather than taking.

**Sell only products we can be proud of.** The test of our standards is that we must be able to personally endorse our products without reservation and consume them ourselves. This principle extends to every part of the business, from the purchasing of ingredients to the point where our products reach the consumer's hands.

**Speak with truth and candor.** We speak up, telling the whole picture, not just what is convenient to achieving individual goals. In addition to being clear, honest and accurate, we take responsibility to ensure our communications are understood.

**Balance short term and long term.** We make decisions that hold both short-term and long-term risks and benefits in balance over time. Without this balance, we cannot achieve the goal of sustainable growth.

**Win with diversity and inclusion.** We leverage a work environment that embraces people with diverse backgrounds, traits and different ways of thinking. This leads to innovation, the ability to identify new market opportunities, all of which helps develop new products and drives our ability to sustain our commitments to growth through empowered people.

**Respect others and succeed together.** This company is built on individual excellence and personal accountability, but no one can achieve our goals by acting alone. We need great people who also have the capability of working together, whether in structured teams or informal collaboration. Mutual success is absolutely dependent on treating everyone who touches the business with respect, inside and outside the company. A spirit of fun, our respect for others and the value we put on teamwork make us a company people enjoy being part of, and this enables us to deliver world-class performance.

## Our Approach to Sustainability

### Sustainability Task Force

In 2004, we formed our Sustainability Task Force (STF), a group made up of senior executives. By year end, we had developed our sustainability vision, which is introduced on page 24, we had agreed upon our approach to sustainability, and we had identified our environmental progress as the STF's first area of focus.

Our overarching goal is to build shareholder value by making PepsiCo a truly sustainable company.

## Minimization and Optimization

PepsiCo's approach to sustainability includes both minimization and optimization efforts. We're committed both to reducing our impacts and to seeking ways to reach optimal solutions. This means we will embark on projects to reduce our use of resources, such as energy conservation, and we'll seek projects that create additional resources, such as use of renewable energy sources.

Our plan is to define our optimal sustainability goals, then work on minimization and optimization programs that will move us closer, or take us to the goals.

## Capital Expenditures Filter

In 2005, we began a project to define sustainability criteria and to ensure that sustainability issues are formally considered in all major capital expenditure proposals. We believe this will ensure that sustainability is a part of our basic business decisions.

# Profile

## Our Business

PepsiCo, Inc. is among the world's leading consumer products companies. We offer great-tasting convenient foods and beverages to consumers throughout the world. The corporation was founded in 1965, but our roots go back more than 100 years. Our principal brands include Frito-Lay, Pepsi-Cola, Tropicana, Gatorade and Quaker, products that generated an estimated \$78 billion in retail sales in 2004.

## Our Constituencies

We interact with many stakeholders.

**Our Investors** — We strive to provide investors a reasonable return on their investment, based on consistent growth in the marketplace and consistent financial results. We take a long-term view and make appropriate investments to strengthen our brands, develop our capabilities and pursue new opportunities. We seek healthy, year-over-year growth, and report our financial results honestly, transparently and on a timely basis.

**Our Associates** — Our associates have always been the greatest factor in our success. We are committed to providing a work environment that allows our employees to achieve professional growth and personal fulfillment.

**Our Customers, Partners and Suppliers** — Our retail customers are the stores and others who carry our products and make them directly available to consumers. We provide our products as well as marketing support and assist in the distribution and promotion of our products.

Our bottlers and other business partners manufacture certain of our products. We provide beverage concentrates and

syrops as well as quality assurance and technical assistance. We provide our bottlers with financial incentives to assist them in the distribution and promotion of our products.

Our suppliers provide us with the goods and services needed in our business. We buy at competitive prices, allowing both our suppliers and PepsiCo to make a reasonable profit. We seek efficient suppliers with whom we can work and grow as long-term partners. We especially seek suppliers that are owned by minorities and women.

**Our Consumers** — We offer consumers great-tasting products that provide outstanding quality, convenience and value. Each year, we invest in innovation to better serve consumer desires and needs through new products and packaging. We continually expand our distribution network to make our products more widely available. And we work relentlessly to improve productivity so we can offer affordable products to a broad range of consumers.

**Our Communities** — We operate our businesses responsibly and seek to be a positive force. We support our communities through our enterprise — with the payroll we generate, taxes we pay and other businesses we support — by contributing to not-for-profit groups and by working with organizations dedicated to improving the lives of people.

**Our Stakeholders** — We welcome and engage in honest discussion with individuals, groups and advocates who represent community, environmental and social interests. Issues of concern brought to the attention of PepsiCo are considered with a view toward our businesses and sphere of influence.

## Associate Numbers

(Approximate at year-end 2004)

U.S.	62,000
International	91,000
Total	153,000

PepsiCo associates are primarily full-time. The majority of our associates are engaged in making, distributing and selling our products. Our franchised bottlers and other partners independently employ many additional people who make, sell and deliver our brands. They are not PepsiCo employees.

The largest concentration of our associates outside the United States is in Mexico, (approximately 35,000 associates). Egypt/North Africa (approximately 8,000), Canada (approximately 7,000) and Brazil (approximately 6,000) are other countries where we have a significant number of associates. In India, China, the United Kingdom, Colombia and Spain, we have fewer than 5,000 associates in each country. We have fewer than 2,000 associates in Australia, South Africa, Venezuela and Jordan. In all other countries, we employ fewer than 1,000 associates.



## Stakeholder Engagement

PepsiCo actively listens to stakeholders and acts on recommendations considered appropriate and where we can make the most difference. Here are some recent examples of stakeholder engagement.

**Global Reporting Initiative** — PepsiCo has a long history of corporate responsibility and has shared information on our website, in prior annual reports and in our Environmental Report. After the Global Reporting Initiative (GRI) guidelines were published in 2002, the Comptroller of the City of New York asked PepsiCo to consider adopting the GRI. As a company with well-known brands, he felt we could be a strong example of corporate responsibility. We met with members of the Comptroller's office and after researching the GRI and how PepsiCo could use the GRI, we began reporting using the guidelines.

**HIV/AIDS** — In 2002, our Simba South Africa snack food operation adopted a formal HIV/AIDS policy and started an intensive HIV/AIDS program. That same year, we began a series of meetings with the Global Business Coalition (GBC), a group dedicated to helping the business community fight HIV/AIDS. These meetings resulted in PepsiCo becoming a member of the GBC. We also established an internal task force to gather data as well as to monitor and respond to issues related to the disease. When we received a shareholder proposal for our 2003 Annual Meeting on HIV/AIDS and related illnesses, we began a series of discussions with the GBC and the shareholders. These discussions led to the development of a worldwide policy on HIV/AIDS.

**Water** — Water is one of the key resources used in the manufacturing of our products, most obviously the sale of our bottled waters. As a result of a series of dialogues with shareholders, we're further increasing our focus on water.

**Recycled content in plastic bottles** — In 2002, shareholders asked PepsiCo to include 10% recycled content in our carbonated soft drink bottles. The goal was to improve the environment and encourage recycling. We committed to include 10% recycled content in Pepsi-Cola plastic bottles by 2005. We have also launched a number of initiatives to encourage recycling.

**Associates** — We ask associates to respond to an "Organizational Health" survey every other year. Topics include benefits, working conditions, compensation, career development, diversity and inclusion initiatives, community activities and many others. The results of the survey are shared with associates and action plans to address issues are developed and made a part of performance goals.

## Governance Structure and Management Systems

### Our Structure and Governance

PepsiCo was founded in 1965 on a handshake between Donald M. Kendall, president and chief executive officer of Pepsi-Cola, and Herman W. Lay, chairman and chief executive officer of Frito-Lay. Trust has been a cornerstone of

PepsiCo since the merger of the two companies. Today, we pursue that goal as vigorously as ever.

**Our Board of Directors** has 11 independent outside directors (85%) and 2 inside directors. PepsiCo's business strategy and affairs are overseen by the Board of Directors. Members of the Board are kept informed of the company's business through discussions with the chairman and CEO, and with other key members of management, by reviewing materials provided to them and by participating in Board and Committee meetings. There are three Committees of the Board: Nominating and Corporate Governance, Audit and Compensation.

**Our Nominating and Corporate Governance Committee's** duties include: (a) identifying and recommending qualified candidates for membership on the Board and Committees of the Board; (b) developing and recommending to the Board corporate governance principles and the Worldwide Code of Conduct and monitoring compliance with such principles and policies; (c) developing criteria to assess the independence of members to the Board; (d) making recommendations to the Board concerning the composition, size, structure and activities of the Board and its committees; and (e) assessing and reporting to the Board on the performance and effectiveness of the Board and its committees and reviewing and reporting to the Board on director compensation and benefits.

**Our Audit Committee's** primary responsibilities are to assist the Board's oversight of: (a) the quality and integrity of the company's financial statements, and its related internal controls over financial reporting; (b) the company's compliance with legal and regulatory requirements; (c) the independent auditor's qualifications and independence; and (d) the performance of the company's internal audit function and the independent auditors. The Audit Committee also has oversight responsibility for risk management policies and procedures.

**Our Compensation Committee's** primary duties are to: (a) oversee the policies of the company relating to compensation of the company's executives and make recommendations to the Board with respect to such policies; (b) produce a report on executive compensation for inclusion in the company's proxy statement; and (c) monitor the development and implementation of succession plans for the CEO and other key executives, and make recommendations to the Board with respect to such plans.

**Board Selection** — The Nominating and Corporate Governance Committee established a director nomination process to identify nominees for the Board of Directors to be elected each year at the Annual Meeting of Shareholders. Shareholders and non-shareholders can submit director nominations to the secretary of the company. From time to time, the Nominating and Corporate Governance Committee

engages consulting firms to perform searches for directors. Nominations are reviewed by the chairman of the Nominating and Corporate Governance Committee to determine whether the candidate possesses the minimum qualifications set forth in the Corporate Governance Guidelines, and if so, whether the candidate's expertise and particular set of skills and background fit the current needs of the Board. If the candidate meets the requirements for a current vacancy on the Board, the submission materials are reviewed with the Nominating and Corporate Governance Committee and are responded to by the chairman of the Committee or his designee. The Committee also reviews the nominations to determine whether the candidate has displayed high ethical standards, integrity and sound business judgment. This process is designed to ensure the Board includes members with diverse backgrounds, skills and experience, including appropriate financial and other expertise relevant to the business of the corporation.

**PepsiCo Executive Risk Council (PERC)** — PepsiCo is subject to risks in the normal course of business due to adverse developments affecting our reputation, information technology, product demand and retail consolidation, global economic and environmental conditions, regulatory environment, workforce retention and market risks. These risks are managed through an integrated risk management framework overseen by the Audit Committee.

**Code of Conduct** — Since 1976, PepsiCo has had a Code of Conduct that applies to every associate. The Code covers many aspects of our business and is distributed globally in more than 30 languages. Each year, we require every division president to report to the Board of Directors on the process used to make sure the Code is read and understood by every associate. In addition, specific employees, including management and any individual with access to sensitive information or in a position to purchase goods and services, are asked to certify that they have followed the Code.

**Disclosure Committee** — This committee is responsible for assisting the senior officers in fulfilling their responsibility for oversight of the accuracy and timeliness of the disclosures made by the company.

**Compliance Program** — We have appointed a senior executive who has responsibility for developing and implementing a comprehensive program to assist the company in complying with applicable laws, regulations and policies.

**Independent Auditors** — We have always limited the amount of non-audit services provided by our external auditors. In 2002, we adopted a formal policy that prohibits our external auditors from providing any tax or non-audit services that are not an extension or do not enhance the efficiency of the audit or audit-related services. We will not hire anyone from our independent audit firm who has worked on our audit in the past two years.

**Exercise and Hold Policy** — Under a policy revised in 2002, certain employees and directors may trade PepsiCo stock only during specific limited time periods. Furthermore, senior executives' and directors' annual option exercises for cash are limited to 20% of vested gains. Any proceeds in excess of this limit must be held in PepsiCo shares for at least one year after the date of exercise.

**Stock Ownership Guidelines** — Stock ownership guidelines clearly align the interest of management, directors and shareholders. Senior executives and directors are required to own multiples of their salary in PepsiCo stock.

**Financial and New York Stock Exchange Certifications** — PepsiCo was among the first corporations to comply when the Securities and Exchange Commission required written certification of financial statements by CEOs and CFOs. Since then, our CEO and CFO have issued certifications every quarter. PepsiCo has also submitted its CEO certification as required by the New York Stock Exchange (NYSE). In addition, we have a written statement of management's responsibility on Internal Control over Financial Reporting.

**Open Communication** — To promote high ethical standards across a global organization, we ensure that employees have clear lines of communication to report potential issues. We have a telephone hotline called "Speak Up" for this purpose. It is accessible from around the world at no charge to employees. To further ensure an open communication environment, employees may remain anonymous.

**Shareholder Communication** — To facilitate communication with our shareholders, we provide a telephone number, address and email address to contact our Board of Directors. These may be found under "Contacts" on our corporate website. In the annual proxy statement, distributed to all shareholders, PepsiCo reminds shareholders that the company welcomes comments and suggestions. All communications sent to the Board are reviewed by the PepsiCo Corporate Law Department. Certain communications will be sent to the Chair of the relevant committee or an individual Board member. Complaints or concerns relating to PepsiCo's accounting, internal accounting controls or auditing matters will be referred directly to members of the Audit Committee.

### Corporate Governance Rating

Several independent organizations rate companies on the quality of their corporate governance. PepsiCo received a perfect 10 out of 10 corporate governance rating from Governance Metrics International in 2004. Forbes magazine gave PepsiCo an A+ for Corporate Governance and Institutional Shareholder Services said PepsiCo outperformed 97.1% of the S&P 500 companies and 99.2% of the food, beverage and tobacco companies.

## Our Policies and Management Systems

### Charters, Principles and Memberships

PepsiCo has strong internal principles and charters to guide behavior. We have joined in external efforts related to specific goals. These include:

- **Family-Friendly Programming Forum** — PepsiCo is part of a group of advertisers who have taken positive steps to increase family-friendly programming choices on television.
- **Global Business Coalition on HIV/AIDS (GBC)** — The GBC is an alliance of international companies dedicated to combating the AIDS epidemic.
- **Sullivan Principles** — The goal of the Principles is to support economic, social and political justice by companies where they do business, to support human rights and to encourage equal opportunity at all levels of employment.
- **World Business Council for Sustainable Development (WBCSD)** — The WBCSD is a coalition of approximately 170 international companies united by a shared commitment to sustainable development. PepsiCo joined in 2004.

### Trade and Professional Groups and Standards

PepsiCo and its various businesses belong to a variety of trade and professional and environmental groups which have adopted voluntary standards. These are sometimes local and specific to the business. A partial list includes:

- **Beverage Product Environmental Council (BPEC)** — This is a U.S. beverage industry group committed to increasing beverage container recycling rates.
- **PepsiCo joined Energy Star**, the U.S. Environmental Protection Agency Program focused on improving energy performance.
- **In the United Kingdom**, as part of the Kyoto Treaty, we are a part of the Climate Change Levy with carbon emission targets.
- **In Mexico**, PepsiCo Sabritas is a founding partner of SUSTENTA, a philanthropic group committed to improving solid waste management.
- **Sabritas also presides over the Communication Council Association** to promote development of a productive, united and just society.
- **Frito-Lay has joined the U.S. Environmental Protection Agency (EPA) Climate Leaders program**. This is a government-industry program focused on voluntary reduction of greenhouse gases from industrial operations.

## Performance Indicators

### Economic

#### Our Economic Contributions

**Shareholders** — We provide shareholders with a strong return on their investments. In 2004, we paid \$1.3 billion in dividends and provided shareholders with a 14% total return, which is stock appreciation plus dividends reinvested.

**Associates** — We directly employ more than 153,000 people. Our customers and business partners, such as franchised bottlers and licensees, employ tens of thousands of additional people as they manufacture and distribute our brands.

**Retail Sales** — We create jobs and opportunities for our customers in millions of stores around the world. Our brands are among the most profitable that retailers carry.

**Purchases** — In 2004, we purchased more than \$10 billion in supplies, services and raw materials. These purchases help to support hundreds of thousands of additional jobs and many communities. Goods and services from women-owned and minority-owned businesses accounted for \$831 million in purchases in 2004. Since we began tracking our spending in 1982, PepsiCo has purchased goods and services from minority and women suppliers worth nearly \$7 billion.

### Supplier Diversity Recognitions

- In 2004, the National Minority Supplier Development Council presented PepsiCo with its Corporation of the Year Award and the Leadership Award. No other corporation has won both these awards in one year since 1990.
- The Women's President's Educational Organization (WPEO) recognized PepsiCo as Outstanding Corporation from the New York Region.
- DiversityBusiness.com named PepsiCo one of the Nation's Top 50 Corporations for Multicultural Business for the fourth consecutive year.
- The Chicago Minority Business Development Council's Success Award was presented to PepsiCo for successfully integrating minority suppliers into all areas of its supply chain.

**PepsiCo Supplier Diversity Spending**  
\$ in Millions



**Taxes** — PepsiCo creates economic value for society by providing dividends and return on investment to shareholders and lenders, income and profit to suppliers and co-packers, salaries and benefits to employees, and by paying its fair share of taxes to the public sector. Our businesses have a positive impact on the economies of the countries and



localities in which we operate by generating billions of dollars of revenue for governments through taxes paid directly by PepsiCo and indirectly by PepsiCo's employees, investors, commercial partners and suppliers.

In 2004, PepsiCo paid \$1.8 billion in income taxes worldwide, over \$1.5 billion of which were paid to federal, state and local authorities in the United States. In addition to corporate income taxes, PepsiCo paid hundreds of millions of dollars in payroll, property, transaction-based and other miscellaneous taxes worldwide. These tax payments make an important contribution to the countries and communities in which PepsiCo has a presence.

**Technology** — We share expertise and technologies that provide important benefits to communities and countries. In emerging markets such as India and China, our agricultural development programs have significantly improved crop yields for local farmers. For example, in China, we share knowledge about potato farming with the Chinese Ministry of Agriculture and we have established an advanced potato research laboratory. In India, we used our knowledge of local water sources to improve a water supply for the Kerala area. Following the devastation caused by the tsunami in Southeast Asia, PepsiCo International worked with its local partner, Indofood, to supply water purification systems in Banda Aceh.

## Our Community Support and Charitable Contributions

We give to nonprofit community groups and initiatives through the PepsiCo Foundation, PepsiCo Community Affairs and our various operating divisions. Additionally, we provide gifts-in-kind, support community and nonprofit events, conventions and journals and sponsor meetings. We support employees who volunteer with not-for-profit organizations that encourage employee groups to do volunteer work.

### Contribution Summary

PepsiCo Foundation and Corporate Contributions	\$18.4 Million
Community Affairs and Divisions	\$ 3.5 Million
Estimated In-Kind Donations	\$50.0 Million
Total	\$71.9 Million

## PepsiCo Foundation and Corporate Contributions

The PepsiCo Foundation focuses on three principal areas: health and wellness, diversity and inclusion, and employee involvement. Also the Foundation provides funds for humanitarian aid. These are just some of the efforts and programs.

### Health and Wellness

The Foundation's mission is to advance the knowledge of how to promote healthy lifestyle behavior and effect positive behavior change. Our three areas of focus are community activation, minority communities, and health professionals.

Also, the Foundation supports programs and organizations that encourage young people to be physically active and educates them about the value of healthy eating and a balanced diet.

For example, we are piloting Activa2 in 65 public and private schools in Queretaro, Mexico. The program aims to foster healthy lifestyle habits among Mexican youth by teaching them the concept of energy balance.

### Diversity and Inclusion

We support education and community organizations which foster opportunities, especially for young people, to further their education and economic mobility. Examples include:

- National Council of La Raza for Escalera, a model program that encourages Latino/Hispanic students to graduate from high school and pursue post-secondary education and careers;
- National Hispana Leadership Institute for the Latinas Learning to Lead Youth Institute;
- Texas Christian University in support of Martin Luther King/Henry B. Gonzalez Scholarships;
- National Urban League;
- United Negro College Fund;
- U.S. Pan Asian American Chamber of Commerce for the Executive Leadership Institute, and the Woman Pioneers Symposium; and
- Women's Business Enterprise National Council.

The same spirit of corporate social responsibility is threaded throughout many of our international operations. For example, in China PepsiCo is an active member of the China Women Development Foundation. In Leicester, U.K., the PepsiCo Foundation supports the Enterprising Peepul — Building Diversity Project, to assist ethnic minority small and medium enterprises in growing their businesses.

### Employees

The PepsiCo Foundation is committed to supporting causes which are of value to PepsiCo employees. We support our associates where they contribute and volunteer. Also, the Foundation offers a scholarship program for employees' children.

- The PepsiCo Foundation matches employee gifts to nonprofit organizations through a Matching Gifts program and United Way. Grants are made to nonprofit groups where employees volunteer.
- In 2004, the PepsiCo Foundation partnered with City Year and several human service agencies to support employee community service days focused on addressing the needs of urban and low-income children in New York and homeless children in Mexico City.
- Since 1981 the PepsiCo Foundation has awarded more than \$32 million in college scholarships to children of employees around the world.

**Tsunami Disaster** — PepsiCo International, the PepsiCo Foundation and employees have committed \$2 million toward relief and recovery efforts. Funds were directed to the most urgent areas and projects, and additional local assistance included product donations — especially Aquafina — where fresh water was in critical demand.

**Florida Hurricane Disaster Relief** — The PepsiCo Foundation responded quickly with a gift of \$100,000 to the American Red Cross Disaster Relief Fund. In a collaborative effort with the Salvation Army and the National Council of La Raza, Pepsi-Cola, Frito-Lay, Quaker, and Tropicana products were delivered to the areas most affected by the storms.

## Community Affairs

By helping communities, particularly where we operate, we strengthen the community, develop the workforce and supplier base and contribute to a better quality of life. Some examples include:

- Community Service Week when more than 700 associates at PepsiCo Headquarters in Purchase, NY spent a week volunteering at the Martin Luther King, Jr. Center in New Rochelle, NY and the Emmanuel Children's Mission in Mount Vernon, NY. The volunteers' work ranged from painting and landscaping to leading children's activities. Each year, PepsiCo volunteers participate in a community project.
- America on the Move, whose national presenting sponsor is PepsiCo, held its first America on the Move Day. The organization encourages Americans to become more active and eat more healthfully.
- PepsiCo employee networks sponsor volunteer events. These include reading to youngsters, educating youngsters about the business world and volunteering at soup kitchens and food shelters.
- PepsiCo employees participate in a variety of events that are supported by the company. Examples include Junior Achievement, United Negro College Fund, Greater Chicago Food Depository and numerous other food banks, Chicago Cares, Teach for America, Chinese American Service League, Take Stock in Children, March of Dimes' WalkAmerica, Susan G. Komen Race for the Cure, various marathons that support research efforts on behalf of AIDS, cancer, diabetes and heart disease and many more.

## In-Kind Donations

PepsiCo provides in-kind donations for many nonprofit organizations. The largest program is America's Second Harvest and its network of food banks. In 2004, PepsiCo contributed more than 30 million pounds of food product donations to America's Second Harvest. The Quaker contribution alone represented more than \$46 million in food products. Additional in-kind donations of product, premiums, equipment, printing services, meeting space and services and other donations are made regularly.

## International Contributions Recognized

Sabritas, our PepsiCo snack food business in Mexico, received the Best Practices in Corporate Social Responsibility Award from the Mexican Center of Philanthropy. The award recognized the company for initiatives to promote a better business and social environment in Mexico.

PepsiCo China has been named one of 19 "Most Influential Multinationals in China." Corporate image, competitiveness, leadership skill, human resources capability and social responsibility were some of the benchmarks against which the companies were evaluated.

## Environmental

### Our Environmental Principles

We are committed to being an environmentally responsible company and operating in an environmentally sustainable way. Our policy is to comply with, or exceed, requirements of all applicable laws and regulations. In the absence of specific laws and regulations, our goal is to apply prudent environmental management practices, manage environmental risks and operate responsibly.

### Our Environmental Approach

Historically, each of our operating units worked independently to handle environmental programs. As our operating structure has changed, so has our environmental management structure.

In 2001, we created our Environmental Task Force representing all our operating units to address environmental issues on a company-wide basis and share best practices. In 2002, the Environmental Task Force developed an Environmental Management System (EMS) framework to guide basic environmental activities throughout the company. In 2003, we adopted the Global Reporting Initiative guidelines and reviewed the data we would need to collect on a company-wide basis. In 2004, we established our Sustainability Task Force (STF), which will oversee environmental progress using the minimization and optimization approach.

We look at our programs in terms of five areas: water, packaging, waste, energy and emissions. Our plans include continuing to inventory and develop environmental capabilities, projects and measurements across PepsiCo. The following discussion includes just some of our initiatives.

### Our Environmental Programs

Here are some highlights of our environmental programs.

**FLNA** has a well established Environmental Management System that generally meets the ISO 14001 international standard. In 2004, FLNA continued to drive its Resource Conservation program focusing on reducing consumption and increasing efficiency of energy and water use. When measured on the basis of use per pound of product (with 1999 as the baseline year), Frito-Lay had reduced its water





## Advantage: Responsibility

*We take our responsibility to our environment seriously. We have many programs designed to reduce our environmental impact. This new service center in Rochester, NY, captures solar energy, uses natural light and was designed with environmentally friendly materials. The project team includes, from left to right, John Lonati, area operations manager; Kert King, zone sales leader; Jeff Wadsworth, director of service and distribution; Jim O'Brien, region project manager; and Rick Clark, zone operations manager.*

consumption by more than 26%, fuels consumption by more than 18% and electric consumption by more than 13% as of the end of 2004. These achievements are driven through team awareness and behavioral improvement programs, as well as investment in higher efficiency equipment and modification of processes to use less energy and water. In 2004, Frito-Lay also completed construction on three new photovoltaic generation projects at distribution centers in California, increasing its renewably generated electricity by more than 150%.

**PepsiCo Beverages and Foods (PBF)**, made up of PBNA and QFNA, has embarked on programs similar to Frito-Lay's Resource Conservation efforts. Facilities are developing a detailed Environmental Management System to support and sustain environmental risk management, compliance and sustainability efforts. A few elements of this system include:

- A proactive and comprehensive risk identification, evaluation and control process focusing on 12 priority environmental programs at each facility.
- An annual division- and facility-level planning process to institute environmental risk mitigation programs targeting zero incidents and loss.
- An "early management" process to identify, evaluate, and control environmental risks and assure compliance throughout the life cycle of the project planning process. This process will include sustainability criteria incorporated into the capital expenditure process.
- Third-party environmental risk management and compliance audits, covering applicable environmental programs, at each facility.

## Water

All our products use water, whether in growing the ingredients for our products such as oranges, oats, potatoes and corn, or in the manufacturing of the beverages bearing our brand names, such as carbonated soft drinks, non-carbonated beverages and Aquafina bottled water.

The FLNA water program includes water conservation targets for water use and weekly water use tracking. Water is reused in manufacturing processes to the maximum extent possible and wastewater is often collected, processed and reused to irrigate other agricultural products such as alfalfa and Bermuda grass hay.

Our beverage businesses have implemented projects that are saving water. Tropicana recaptures and reuses more than half a million gallons a day at its Florida plants. The water is used for cleanup and washdown. Gatorade is installing state-of-the-art high speed lines with advanced air rinsing of empty Gatorade bottles.

Our international beverage and snack operations have implemented a number of water projects. For example, in Europe, India and Latin America, rainwater is harvested to help replenish aquifer supplies.

We also recognize the need to share our expertise. In Kerala, India, we helped increase the depth of the local well in order to improve the town's water supply. When the tsunami hit Southeast Asia in December 2004, we provided technical help in establishing water purification systems and in sanitizing the many community wells that had become contaminated.

Most PepsiCo U.S. facilities obtain water from municipal supplies. Our research shows the quantities of water withdrawn do not result in any significant impacts to related ecosystems or habitats. Relative withdrawals from local ground and surface water supplies are very low at all locations, and in the range of 0 to 5% of the total renewable quantity available.

The majority of PepsiCo processing wastewaters are discharged to municipal wastewater treatment facilities after on-site pretreatment to recover by-product materials and reduce the loading to the municipal treatment facility.

## Packaging

We have programs to reduce, reuse and recycle our packaging. Soft drink containers are the most-recycled packages in the United States. In addition, the amount of material used to make every can and bottle of our brands has been reduced significantly. It takes almost 60% less packaging to sell one liter of soft drinks today than was used in 1990.

Our use of recycled materials has also expanded. Each year in the United States, Pepsi-Cola cans are made with 50% recycled aluminum. In 2002, we pledged that PepsiCo would begin working with our bottlers to use recycled plastic in our bottles. In 2005, with the help of our bottlers, we expect to meet our commitment to use 10% recycled content in our plastic bottles.

PepsiCo is also concerned over decreasing recycling rates, although the problem is not limited to beverage containers, which represent less than 2% of the municipal solid waste stream. We are working with our bottlers, suppliers and industry associations, along with our communities, to identify ways to raise recovery rates economically.

Each of our divisions has reduced packaging by reducing the weight of its packaging and taking steps to make our packages more recyclable. For example, Quaker Foods eliminated the fluted cardboard found sandwiched between the two cardboard layers in the consumer Club boxes for instant oatmeal. In addition, cereal boxes and oatmeal tubes use at least 40% recycled content.

We also continue to provide major support to Keep America Beautiful and its leading voluntary anti-litter campaign, the Great American Clean-up.

## Waste

Waste from PepsiCo includes natural wastes, such as orange peels and starch from potatoes. It includes solid wastes such as packaging and office waste. And it includes wastewater. In each instance, PepsiCo has longstanding programs to reduce, reuse and recycle.

Frito-Lay is the second-largest producer of industrial grade potato starch in the United States. Each year, Frito-Lay recovers some 60 million pounds of starch, reducing costs as well as the waste it would otherwise send to municipal wastewater treatment plants. The starch is then sold to industrial manufacturers for use in production of paper and coating products.

Packaging and office wastes are recycled at most facilities. In Europe, Frito-Lay packaging waste is turned into plastic pellets and in Europe and Japan packaging waste is burned to produce energy.

Frito-Lay's Rosenberg manufacturing facility in Texas uses methane gas harvested from the nearby Fort Bend County landfill to operate the plant's utility boiler. Our Fort Pierce Tropicana plant has recently entered into an agreement with the Saint Lucie County landfill to use the landfill's by-product methane gas to supplement energy needs. Both of these projects also have a positive environmental impact because methane, a greenhouse gas, is being captured and beneficially used.

Tropicana uses virtually every part of the orange, including the peels, which are sold as cattle feed. Quaker Foods also captures food waste to be used as animal feed, as well as for bedding and other beneficial agricultural uses.

In 2004, the Quaker Foods plant in Cedar Rapids received the Governor's Iowa Environmental Excellence Award, including two special recognition awards for Air Quality and Energy Efficiency and Renewables. The Award recognized the plant's project to use the oat hulls that are generated as a by-product (amounting to approximately 360 tons per day) as a renewable biomass fuel source for the University of Iowa power plant. By using the oat hulls as a fuel source, the University of Iowa power plant has reduced emissions and reliance on non-renewable fossil fuels. In addition, significant landfill space has been saved. Recently, the plant has entered into an agreement with a local food company to use a portion of the oat hull stream as a food additive.

## Energy

FLNA's manufacturing plant in Bakersfield, California and Tropicana's Bradenton, Florida plant produce energy through cogeneration. Excess electricity is sold to the local utility company. High efficiency, low-nitrogen oxide burners have been installed at most Frito-Lay and PBF plants. Frito-Lay service centers are increasingly constructed to use natural daylight to light the building, instead of artificial

lighting. Features of the new service center in Rochester, NY include using natural daylight, solar electricity generation and porous pavement for improved capture of water run-off.

In 2004, PBF converted several facilities to energy efficient lighting. Tropicana's Bradenton, Florida plant is changing the orange juice block freezing process to aseptic tank refrigerated storage, dramatically decreasing energy requirements.

Our international businesses also have active environmental programs. For example, Walkers Snack Foods, Ltd., our United Kingdom snack food company, is part of an industry initiative to reduce energy consumption.

## Emissions

Our facilities primarily burn natural gas, which produces lower emissions of air pollutants than other fuels. We have many programs such as source reduction and pollution prevention initiatives, and installation of state-of-the-art air emissions control equipment to minimize emission of air pollutants. FLNA has reduced greenhouse gas emissions by 13% since 1999. We are testing hybrid engines for our fleet and we have re-engineered our Frito-Lay sales routes to reduce fuel consumption. In 2004, Frito-Lay was awarded a grant from the Texas Commission on Environmental Quality to test hybrid electric delivery trucks that will reduce air pollution in the Dallas-Fort Worth and Houston-Galveston areas.

Sabritas, our Mexican snack food business, has been using electric-powered delivery vans since 1993 to serve urban centers in Mexico. These vans are equipped with rechargeable batteries and release no toxic emissions.

## Environmental Awards

- Quaker Foods received the Governor's Iowa Environmental Excellence Award for our project to use oat hulls as a fuel source.
- PepsiCo World Headquarters was named "Best Workplace for Commuters" by the U.S. Environmental Protection Agency. The award spotlights employers that have made a commitment to provide commuter benefit packages that help reduce traffic, air pollution and improve the quality of life for commuters.
- Frito-Lay was honored for the eighth consecutive year in the California Waste Reduction Awards Program (WRAP). The award is given to businesses in the state for outstanding achievement in reduction, recycling and conservation.
- Sabritas, our snack food business in Mexico, won a National Award of Thermic Energy Saving.
- Pepsi India's Madurai plant received a Golden Peacock Environment Management award for improvements in water usage and energy consumption.

## Our Employee Policies and Programs

### Diversity and Inclusion

PepsiCo approaches diversity and inclusion as a fundamental strategic priority. We believe our leadership in this area gives us an opportunity to drive our growth and gain a competitive advantage.

The business rationale is clear: Minority populations are growing faster than the population overall. Each year, racial and ethnic minorities constitute a greater share of our potential consumers, employees and retail customers.

To attract and retain the brightest, most capable people, we must create a diverse and inclusive culture where everyone feels they have equal opportunity to succeed and grow — regardless of gender, race, ethnicity, religion or sexual orientation. Our equal opportunity policies are strictly enforced. We set goals for improving the representation of women and people of color within our workforce and we link executive compensation to the achievement of these goals. We require managers to include diversity and inclusion goals as part of their performance objectives. We have active employee networks for our various groups, including women, Latinos, African Americans, Asians and Gay/Lesbians. All employees participate in inclusion training sessions. Our Harvey C. Russell Inclusion Award was introduced in 2003 to recognize outstanding achievement in support of PepsiCo's diversity and inclusion efforts. It is named after Harvey C. Russell, who in the 1960s became the first African American of a major national corporation to be promoted to a corporate vice president. Pepsi-Cola named him to that position.

Our Ethnic Advisory Boards, shown on pages 20 and 21 of this report, have provided excellent counsel on a broad range of social, cultural and business issues, including marketing, hiring, benefits and diversity.

### Diversity Awards

- The National Association for Female Executives (NAFE) named PepsiCo among the "NAFE Top 30 companies for Executive Women."
- DiversityInc ranked PepsiCo #5 in its 2004 list of the "Top 50 Companies for Diversity." PepsiCo was ranked first in both the "Top 10 Companies for African Americans" and the "Top 10 Companies for Latinos."
- Fortune magazine named PepsiCo #7 on its list of "50 Best Companies for Minorities."
- The Black Collegian magazine named PepsiCo among its "Top Diversity Employers for 2004."
- LATINA Style magazine named PepsiCo among the "50 Best Companies for Latinas to Work for in the U.S."
- Essence magazine named PepsiCo one of "30 Great Places to Work" for African American women.

### U.S. Diversity and Inclusion Statistics

In 2004, we increased the number of our minority employees to 29%, up from 27% in 2003. Our minority managers increased to 20%, up from 19% in 2003. We also successfully increased the number and percentage of women managers, up to 24% from 23% in 2003. Our Board of Directors is pictured on page 19. Our Senior Managers are named on page 18.

	Total	Women	%	Minority	%
Board of Directors	13	3	23%	4	31%
Senior Managers	14	3	21%	3	21%
All Employees	62,239	16,185	26%	17,838	29%
All Managers	7,227	1,761	24%	1,468	20%

### Safety

Our Code of Conduct includes a commitment to provide safe and healthy workplaces. In the United States, this clear corporate commitment is combined with training and monitoring. At FLNA, each site has a safety manager who is responsible for safety. At PBF sites, dedicated health and safety professionals lead comprehensive risk management programs focused on preventing workplace illnesses and injuries. It is our policy to comply with all applicable safety and health laws and regulations. We design, construct and maintain our operating facilities in a manner to protect our people and physical resources. For example, almost two-thirds of Frito-Lay plants and all of Tropicana plants have earned "Star" certification in OSHA's Voluntary Protection Program for facility workplace safety excellence.

### Benefits

In the United States, we offer a full range of health care, savings and retirement benefits. Our health and welfare benefits include medical, dental, vision, prescription drug, mental health, life and accident insurance, disability and flexible spending accounts. We also offer commuter reimbursement, group legal benefits, tuition reimbursement, adoption assistance, Employee Assistance Program, child care referral and resources, smoking cessation programs and family and medical leaves. In 2004, we introduced HealthRoads, a new wellness benefit for employees and their families. HealthRoads provides information, resources and tools, as well as financial incentives, to encourage employees and their families to live healthier lifestyles. Domestic partners who meet certain eligibility requirements may be covered under these benefits.

There is a formalized procedure for appeals related to PepsiCo employee benefit claims. This information is provided along with benefit details.

Financial benefits include company-funded pension plans, a 401(k) Plan with a company match, the PepsiCo Stock Purchase Program and SharePower, a broad-based stock option program. SharePower was introduced in 1989 and is a global program that offers eligible employees stock options that may be exercised after a vesting period. We believe SharePower clearly reflects a culture that places a high priority on ownership.



Our various headquarters offer on-site fitness centers and wellness classes. We offer lifestyle benefits such as on-site banking and other amenities.

## HIV/AIDS

HIV/AIDS is posing an increasingly overwhelming global health risk to human society. PepsiCo has recognized the importance of HIV/AIDS and has joined the fight.

In 2002, PepsiCo's South Africa snack food operation, Simba, adopted a formal HIV/AIDS policy. Key elements of the policy include non-discrimination, non pre-employment screening, a uniform approach to managing HIV positive employees, commitment to treat HIV/AIDS in the same manner as other life threatening illnesses, company-sponsored HIV/AIDS related prevention and training programs, and reasonable accommodation to people with life threatening diseases including HIV/AIDS.

After establishing extensive education and prevention programs, providing testing and treatment assistance to employees and engaging in community outreach, Simba extended its Direct AIDS Intervention Program (DAI) to all employees and spouses in 2004. The company has invested an estimated \$300,000 to ensure universal enrollment, accelerate testing and provide comprehensive treatment.

Also in 2002, PepsiCo joined the Global Business Coalition (GBC), a not-for-profit group dedicated to fighting HIV/AIDS and related diseases by providing information, counsel and sharing best practices. That same year, PepsiCo established an internal task force on HIV/AIDS whose purpose is to gather data as well as to monitor and respond to issues related to the disease. These issues include employee policies and programs and encouragement of community outreach efforts.

In addition to South Africa, the task force has identified priority countries where there is high or rising prevalence and where we have major operating facilities: India, China and Russia. The task force is currently focusing on these four countries, although work is also being done in other countries, such as Thailand.

We have prepared a report which covers the known impact of HIV/AIDS on our businesses in the identified countries, the PepsiCo Worldwide HIV/AIDS policy, programs in the identified countries related to HIV/AIDS, as well as our community and public response and future plans. This report, as well as additional information about PepsiCo programs in South Africa and PepsiCo services to support those with HIV/AIDS in the United States, may be found on our website <http://www.pepsico.com> under Citizenship/HIV/AIDS Initiatives.

## Human Rights

Our Values include a commitment to respect others, inside and outside the corporation, which is consistent with treating all people with dignity. Our commitment to our employees includes a work environment that is free from all forms of discrimination, including sexual and other forms of harassment, and to fostering a work environment where people feel comfortable and respected. PepsiCo's Code of Conduct requires all employees to follow local employment laws and regulations, including child labor laws and treatment of employees.

## Human Rights Training

Every PepsiCo associate receives training in our Code of Conduct and Speak Up hotline, which include respect for our employees. In addition, in the United States, PepsiCo has provided Inclusion training to more than 11,000 associates, including all managers. During this training, we explore the human rights intrinsic to all and the importance of sustaining an inclusive culture.

## Reporting Issues and Speak Up

The employee grievance system includes employee and manager communications, intervention by human resources generalists, and the Speak Up Line. All associates can use Speak Up as a method to raise any issue.

Speak Up is a 24-hour, toll-free, anonymous hotline available to report any suspected misconduct or business abuse. Speak Up calls are received by a third-party vendor — not a PepsiCo employee — to ensure anonymity. All calls are free to employees and contractors. The toll-free numbers and an explanation of Speak Up are provided on the PepsiCo intranet and in the PepsiCo Worldwide Code of Conduct. The Code includes PepsiCo's policy prohibiting retaliation against employees and contractors who raise grievances.

PepsiCo has had a Speak Up program since 1999 when it was introduced at Frito-Lay North America. In 2001, the Speak Up program was introduced to other employees in the United States. The Speak Up program was extended to international employees in 2003.

## Advantage: Diversity and Inclusion

*We see the diversity of our suppliers, business partners and associates as a competitive advantage in the marketplace. We know how to appeal to various groups because we are part of these groups. Consumers don't see the many different viewpoints and ideas behind our products, but they enjoy the results.*



## Our Business Policies and Programs

### Community Programs

PepsiCo has a long history of community involvement that first, recognizes the impact our business has on the communities in which we operate; and second, understands that long-term relationships with communities based on trust and mutual interests are vital to PepsiCo's business strategy.

To meet this commitment, PepsiCo has focused on the following four guiding principles:

- 1) To understand the development needs of the local communities and to look for those areas in which PepsiCo's and the communities' interests overlap and are mutually advantageous.
- 2) To develop and maintain effective long-term relationships with both local and national organizations based on trust and mutual respect.
- 3) To focus PepsiCo's resources in terms of funding, time and skills to help communities build leadership capacity, build capability among youth in the areas of life skills, education, entrepreneurship, as well as create economic development within urban communities.
- 4) In support of PepsiCo's diversity and inclusion initiative, to place significant focus on organizations reflecting major ethnic groups.

To convert this commitment to reality, PepsiCo supports employee engagement and volunteerism, more than 30 national community-based organization conferences and events, employee involvement in not-for-profit organizations, as well as in-kind gifts, such as product, premiums, printing, meeting space, and equipment donations.

### Bribery and Corruption

Our business decisions are made on merit. Our Code prohibits employees from giving or offering anything of value to government officials to influence a discretionary decision and does not allow employees to give gifts or entertainment unless permitted by applicable law and division policies. Our Code also requires that we observe the most stringent standards in the keeping of financial records and accounts. PepsiCo's compliance programs include training on anti-bribery laws and prohibit associates from receiving, offering or giving anything that might be considered an inducement to influence a business decision. The PepsiCo Law Department provides periodic training to associates with respect to compliance related matters.

### Commitment to Competition

Our commitment to fair competition and the importance of compliance with laws prohibiting restraints of trade, predatory economic activities and other anti-competitive business practices are communicated to associates through the PepsiCo Worldwide Code of Conduct and the specific competition policies maintained by the divisions. In addition, our competition policies are communicated and compliance

training accomplished at the division level using a variety of means, including regular presentations to sales personnel in the field and at headquarters, incorporation in sales training materials, and through frequent attorney consultation on specific issues. In 2004, there were no judicial decisions under the U.S. competition law relating to our businesses.

### Our Consumer Policies and Programs

#### Health and Wellness

As a food and beverage company, we are committed to making a positive contribution to the diets and lifestyles of our consumers. Our goal is to provide consumers with the products they want and enjoy and to provide choices to meet a broad variety of needs. We also recognize that consumers have an increasing need and desire for foods and beverages that make it easier and more enjoyable for them to lead healthier lives. We are committed to actively promoting health and wellness in ways that serve the public interest and contribute to our growth.

We focus on two broad areas:

- Providing product choices that contribute to healthier lifestyles.
- Encouraging healthy lifestyles.

#### Providing Product Choices

PepsiCo has offered a spectrum of product choices, including better-for-you options, for years. In 2004, we introduced the "Smart Spot," a little green symbol designed to help consumers identify more than 100 PepsiCo food and beverage choices that can contribute to healthier lifestyles. The Smart Spot symbol appears on products that include Tropicana Pure Premium orange juice, Gatorade thirst quencher, Aquafina, Baked Lay's potato crisps, Quaker oatmeal and Diet Pepsi.

Products receiving the Smart Spot symbol meet nutrition criteria based on authoritative statements from the National Academy of Sciences and the U.S. Food and Drug Administration (FDA). The Smart Spot criteria include limits on the amount of fat — including saturated and trans fats — cholesterol, sodium and added sugar. The Smart Spot symbol also identifies products reduced in ingredients, such as sodium or added sugar, or products formulated to have specific health or wellness benefits. The Smart Spot symbol was introduced in Canada in January 2005.

#### Encouraging Healthy Lifestyles

Since 1970, PepsiCo has sponsored programs that encourage children and adults to be more active. Today we support a variety of programs.

- YMCA — A commitment to help financially disadvantaged youth and teens participate in YMCA programs, including its Healthy Kids Camp.



- **Get Kids in Action** — A partnership between Gatorade and the University of North Carolina to reduce and prevent childhood obesity.
- **America on the Move** — A national initiative to help people improve their health through simple changes in diet and exercise (<http://www.americaonthemove.org>).
- **Kidnetic** — The International Food Information Council's web-based program to promote healthy lifestyles in children 8-12 years old ([www.kidnetic.org](http://www.kidnetic.org)).
- **Get Active, Stay Active** — A web-based journal where teens can track their physical activity and eligibility for the President's Active Lifestyle Award. ([www.getactivestayactive.com](http://www.getactivestayactive.com)).
- **Healthy Living Radio with Dr. Ken Cooper** — A syndicated weekly radio show.
- **The American Council on Fitness and Nutrition** — PepsiCo is a founding member.
- **Consortium for Lowering Obesity in Chicago's Children (CLOCC)** — A data-driven obesity prevention effort with an emphasis on evaluation. With a network of more than 400 members, Quaker is a founding member.
- **Chicago Communities in Schools' Healthy Classroom Initiative** — To determine students' current knowledge of health and nutrition and introduce programs to increase their understanding of healthy lifestyles.
- **Balance First** — Lesson plans that teach children the concept of energy balance.

## Product Safety

PepsiCo is committed to providing safe, wholesome products and protecting the equity in our brands, trademarks and goodwill. Our divisions have implemented policies related to food safety, labeling, product integrity and quality.

These policies ensure strict adherence to all applicable regulations and legislation. Our policies cover food safety, sanitation, recalls and allergens and require that our products are coded, labeled, identifiable and traceable. Our compliance systems include website training, monitoring, preventative measures and readiness for corrective action. We have regular management review of our procedures and activities regarding our products.

If remedial action is needed, we respond appropriately. For example, shortly after we purchased SoBe in 2001, we removed some product claims from the labels and subsequently settled an investigation with a state agency involving those prior label claims.

## Consumer Relations Policies and Procedures

Packages produced in the United States under the authority of PepsiCo carry a toll-free 800 number and web address to allow consumers easy access to the company if they have a question or comment regarding one of our

products. Each business has a Consumer Relations department that serves as the first point of contact for all communication and correspondence received from our consumers.

Should consumers need to contact us after hours, they can dial our toll-free number and a message will be activated offering them an emergency line number. A special team of Consumer Relations employees can be contacted by our emergency line and will immediately return a call to a consumer or to one of our field representatives.

## Consumer Privacy

Consumer privacy is important to PepsiCo and we make every effort to ensure that consumers understand our policies. Each division maintains its own marketing websites that are accessible by consumers. Brand-specific websites also are maintained. On each website, consumers can voluntarily provide personal information for online programs and promotions. A privacy policy is conspicuously posted on each website that outlines the types of information that are collected by each division on its website and how the information is used and protected. Under the Children's Online Privacy Protection Act, special rules apply to personal information collected from children under the age of 13. These special rules are explained in the privacy policy found on each website. Also, personal information received through the consumer relations toll free number is kept confidential and is not shared outside the company.

## Advertising

PepsiCo has a longstanding policy on the kinds of television programs that can carry our advertising messages. We're committed to high standards in all of our advertising, including the environment in which our advertising appears.

We avoid advertising in excessively violent programs, shows that may be distasteful as judged by contemporary society and those that may be offensive to a large group of people. We also attempt to avoid programs containing material inconsistent with or adverse to products advertised and exceptionally controversial or potentially inflammatory discussions.

We understand that children are a special audience and take particular care evaluating programming that carries messages to children and programs aired at times when children represent a large portion of the audience.

We recognize the importance of using our advertising and promotional programs in a positive way. For example, Chester Cheetah has appeared in South Africa to promote HIV/AIDS awareness. And in 2004, Pepsi-Cola received a Reggie Award for its 2003 "Black History Month: Create Your Own History" promotion.

# Global Reporting Initiative (GRI) Guidelines Index

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\*Reference to the Global Reporting Initiative (GRI) indicators. See <http://www.globalreporting.org/guidelines/2002.asp> for more information.

Note: Some indicators are fully reported, others partially. For a more comprehensive listing, please visit <http://www.pepsico.com>.

## Key

EC — economic  
EN — environmental  
LA — labor practices  
HR — human rights  
SO — society  
PR — product responsibility

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Additional information on these and other PepsiCo initiatives can be found at: <http://www.pepsico.com>.

# Management's Discussion and Analysis and Consolidated Financial Statements

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# Our Business

Our discussion and analysis is an integral part of understanding our financial results. Definitions of key terms can be found in the glossary on page 88. Tabular dollars are presented in millions, except per share amounts. All per share amounts reflect common per share amounts, assume dilution unless noted, and are based on unrounded amounts. Percentage changes are based on unrounded amounts.

## Our Operations

We are a leading, global snack and beverage company. We manufacture, market and sell a variety of salty, convenient, sweet and grain-based snacks, carbonated and non-carbonated beverages and foods. We are organized in four divisions:

- Frito-Lay North America,
- PepsiCo Beverages North America,
- PepsiCo International, and
- Quaker Foods North America.

Our North American divisions operate in the United States (U.S.) and Canada. Our international divisions operate in over 200 countries, with our largest operations in Mexico and the United Kingdom. Additional information concerning our divisions and geographic areas is presented in Note 1.

### Frito-Lay North America

Frito-Lay North America (FLNA) manufactures or uses contract manufacturers, markets, sells and distributes branded snacks. These snacks include Lay's potato chips, Doritos flavored tortilla chips, Tostitos tortilla chips, Cheetos cheese flavored snacks, Fritos corn

chips, Ruffles potato chips, branded dips, Rold Gold pretzels, Quaker Chewy granola bars, Sun Chips multigrain snacks, Munchies snack mix, Grandma's cookies, Lay's Stax potato crisps, Quaker Fruit & Oatmeal bars, Quaker Quakes corn and rice snacks, Cracker Jack candy coated popcorn, and Go Snacks. FLNA branded products are sold to independent distributors and retailers.

### PepsiCo Beverages North America

PepsiCo Beverages North America (PBNA) manufactures or uses contract manufacturers, markets and sells

manufactures, markets and sells ready-to-drink tea and coffee products through joint ventures with Lipton and Starbucks. In addition, PBNA licenses the Aquafina water brand to its bottlers and markets this brand. PBNA sells concentrate and finished goods for some of these brands to bottlers licensed by us, and some of these branded products are sold directly by us to independent distributors and retailers. The franchise bottlers sell our brands as finished goods to independent distributors and retailers. PBNA's volume reflects sales to its independent distributors and retailers, and the sales of beverages bearing our trademarks that franchise bottlers have reported as sold to independent distributors and retailers.

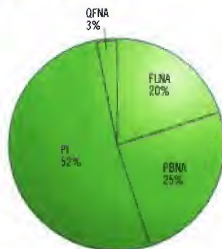
### PepsiCo International

PepsiCo International (PI) manufactures through consolidated businesses as well as through noncontrolled affiliates, a number of leading salty and sweet snack brands including Gamesa and Sabritas in Mexico, Walkers in the United Kingdom, and Smith's in Australia. Further, PI manufactures or

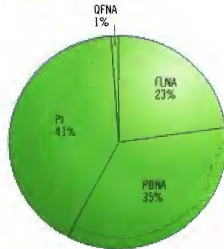
**All of our divisions positively contributed to net revenue and operating profit growth in 2004.**

beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mountain Dew, Gatorade, Tropicana Pure Premium, Sierra Mist, Mug, Tropicana juice drinks, Propel, SoBe, Slice, Dole, Tropicana Twister and Tropicana Season's Best. PBNA also

Net Revenue Contribution to Growth



Operating Profit Contribution to Growth



uses contract manufacturers, markets and sells many Quaker brand snacks. PI also manufactures, markets and sells beverage concentrates, fountain syrups and finished goods under the brands Pepsi, 7UP, Mirinda, Gatorade, Mountain Dew and Tropicana. These brands are sold to franchise bottlers, independent distributors and retailers. However, in certain markets, PI operates its own bottling plants and distribution facilities. PI also licenses the Aquafina water brand to certain of

its franchise bottlers. PI reports two measures of volume. Snack volume is reported on a system-wide basis, which includes our own volume and the volume sold by our noncontrolled affiliates. Beverage volume reflects company-owned and franchise bottler sales of beverages bearing our trademarks to independent distributors and retailers.

**Quaker Foods North America**  
Quaker Foods North America (QFNA) manufactures or uses contract manufacturers, markets and sells cereals, rice, pasta and other branded products. QFNA's products include Quaker oatmeal, Aunt Jemima mixes and syrups, Quaker grits, Cap'n Crunch and Life ready-to-eat cereals, Rice-A-Roni, Pasta Roni and Near East side dishes. These branded products are sold to independent distributors and retailers.

## Our Customers

Our customers include franchise bottlers and independent distributors and retailers. We grant our bottlers exclusive contracts to sell and manufacture certain beverage products bearing our trademarks within a specific geographic area. These arrangements specify the amount to be paid by our bottlers for concentrate and full goods and for Aquafina royalties, as well as the manufacturing process required for product quality.

Since we do not sell directly to the consumer, we rely on and provide financial incentives to our customers to assist in the distribution and promotion of our products. For our independent distributors and retailers, these incentives include volume-based rebates, product placement fees, promotions and displays. For our bottlers, these incentives are referred to as bottler funding and are negotiated annually with each bottler to support a variety of trade and consumer programs, such as consumer incentives, advertising support, new product support, and vending and cooler equipment placement. Consumer incentives include coupons, pricing discounts and promotions, such as sweepstakes and other promotional offers. Advertising support is directed

at advertising programs and supporting bottler media. New product support includes targeted consumer and retailer incentives and direct marketplace support, such as point-of-purchase materials, product placement fees, media and advertising. Vending and cooler equipment placement programs

### **Retail consolidation has increased the importance of major customers and further consolidation is expected.**

support the acquisition and placement of vending machines and cooler equipment. The nature and type of programs vary annually. The level of bottler funding is at our discretion because these incentives are not required by the terms of our bottling contracts.

Sales to Wal-Mart Stores, Inc. represent approximately 11% of our total net revenue. Retail consolidation has increased the importance of major customers and further consolidation is expected. Our top five retail customers currently represent approximately 27% of our 2004 North American net revenue, with Wal-Mart representing approximately 14%. In addition, sales

to The Pepsi Bottling Group (PBG) represent approximately 10% of our total net revenue. See "Our Related Party Bottlers" and Note 8 for more information on our anchor bottlers.

### **Our Related Party Bottlers**

We have ownership interests in certain of our bottlers. Our ownership is less than 50% and since we do not control these bottlers, we do not consolidate their results. We include our share of their net income based on our percentage of economic ownership in our income statement as bottling equity income. We have designated three related party bottlers, PBG, PepsiAmericas, Inc. (PAS) and Pepsi Bottling Ventures LLC (PBV), as our anchor bottlers. Our anchor bottlers distribute approximately 65% of our North American beverage volume and approximately 20% of our international beverage volume. Our anchor bottlers participate in the bottler funding programs described above. Approximately 12% of our total 2004 sales incentives related to these bottlers. See Note 8 for additional information on these related parties and related party commitments and guarantees.

## Our Distribution Network

Our products are brought to market through direct-store-delivery, broker-warehouse and foodservice and vending distribution networks. The distribution system used depends on customer needs, product characteristics, and local trade practices.

### Direct-Store-Delivery

We and our bottlers operate direct-store-delivery systems that deliver snacks and beverages directly to retail stores where the products are merchandised by our employees or our bottlers. Direct-store-delivery enables us to merchandise with maximum visibility and appeal. Direct-store-delivery is

especially well-suited to products that are restocked often and respond to in-store promotion and merchandising.

**Our products are brought to market through direct-store-delivery, broker-warehouse and foodservice and vending distribution networks.**

### Broker-Warehouse

Some of our products are delivered from our warehouses to customer warehouses and retail stores. These less

costly systems generally work best for products that are less fragile and perishable, have lower turnover, and are less likely to be impulse purchases.

### Foodservice and Vending

Our foodservice and vending sales force distributes snacks, foods and beverages to third-party foodservice and vending distributors and operators, and for certain beverages, distributes through our bottlers. This distribution system supplies our products to schools, businesses, stadiums, restaurants and similar locations.

## Our Competition

Our businesses operate in highly competitive markets. We compete against global, regional and private label manufacturers on the basis of price, quality, product variety and effective distribution. Our chief beverage competitor, The Coca-Cola Company, has a slightly larger share of CSD consumption in the United States, while we have a larger share of chilled juices and isotonic.

In addition, The Coca-Cola Company maintains a significant CSD share advantage in many markets outside North America. Further, our snack brands hold significant leadership positions in the snack industry worldwide and face local and regional competitors, as well as national and global snack competitors, on issues related to price, quality, variety and distribution.

Success in this competitive environment is dependent on effective promotion of existing products and the introduction of new products. We believe that the strength of our brands, innovation and marketing, coupled with the quality of our products and flexibility of our distribution network, allow us to compete effectively.

## Other Relationships

Certain members of our Board of Directors also serve on the boards of certain vendors and customers. Those Board members do not participate in our vendor selection and negotiations nor in our customer negotiations. Our

transactions with these vendors and customers are in the normal course of business and are consistent with terms negotiated with other vendors and customers. In addition, certain of our employees serve on the boards of our

anchor bottlers and other affiliated companies and do not receive incremental compensation for their Board services.



# Our Business Risks

**We are subject to risks in the normal course of business due to adverse developments affecting:**

- our reputation;
- information technology;
- product demand and retail consolidation;
- global economic and environmental conditions;
- regulatory environment;
- workforce retention; and
- market risks.

## Our Approach to Managing Risks

**We manage our risks through an integrated risk management framework.**

This framework includes:

- the PepsiCo Executive Risk Council (PERC), comprised of a cross-functional, geographically diverse, senior management group which meets periodically to identify, assess, prioritize and address primarily strategic and reputational risks;
- Division Risk Committees (DRC), comprised of cross-functional senior management teams which meet regularly each year to identify, assess, prioritize and address division-specific operating risks;
- PepsiCo's Risk Management Office, which manages the overall process, provides ongoing guidance, tools and analytical support to the PERC and DRC, identifies and assesses potential risks, and facilitates ongoing communication between the parties, as well as to PepsiCo's Audit Committee; and
- PepsiCo Corporate Audit, which confirms the ongoing effectiveness of the risk management framework through periodic audit and review procedures.

Also see "Market Risks" below for a discussion on how we manage specific market risks.

### Our Reputation

We have a longstanding history of maintaining a good reputation globally which is critical to selling our branded products. If we fail to maintain high standards for product quality and integrity, our reputation could be jeopardized. In addition, we must protect our reputation by maintaining high ethical, social and environmental

**We have a longstanding history of maintaining a good reputation globally which is critical to selling our branded products.**

standards for all of our operations and activities. Damage to our reputation might result in rejection of our products by consumers and a loss of brand equity, as well as require additional resources to rebuild our reputation.

### Information Technology

Information technology is becoming increasingly important as an enabler to operating efficiently and interfacing with customers, as well as maintaining financial accuracy and efficiency. If we do not allocate, and effectively manage, the resources necessary to build and sustain the proper technology infrastructure, we could be subject to

transaction errors, processing inefficiencies, the loss of customers, business disruptions, or the loss of or damage to intellectual property through security breach.

As discussed by our chairman, we have embarked on our multiyear BPT initiative that includes the delivery of an SAP enterprise resource planning application, as well as the migration to common business processes across our North American operations. The inability to deliver our goals may impact our ability to (1) process transactions accurately and efficiently, and (2) remain in step with the changing needs of the

**Information technology is becoming increasingly important as an enabler to operating efficiently and interfacing with customers.**

trade, which could result in the loss of customers. In addition, the failure to either deliver the application on time, or anticipate the necessary readiness and training needs, could lead to business disruption.

### Product Demand and Retail Consolidation

We are a consumer products company operating in highly competitive markets and rely on continued demand for our products. To generate revenues and profits, we must sell products that appeal to our customers and to consumers. As our chairman notes, our continued success is dependent on our product innovation, including maintaining a strong pipeline of new products, effective sales incentives, appropriate advertising campaigns and marketing programs, and the ability to secure adequate shelf space at our retailers. In addition, our success depends on our responses to consumer trends, such as low carbohydrate diets, consumer health concerns, including obesity and the consumption of certain ingredients, and changes in product category

consumption and consumer demographics, including the aging of the general population. Seasonal weather conditions, particularly for sports drinks and hot cereals, can also impact demand. Our top five retail customers now represent approximately 27% of our North American net revenue reflecting the continuing consolidation of the retail trade. In this environment, there continue to be competitive product and pricing pressures, as well as challenges in maintaining profit margins. We must maintain mutually beneficial relationships with our key customers, including our retailers and anchor bottlers, to effectively compete.

#### **Global Economic and Environmental Conditions**

Unforeseen global economic and environmental changes and political unrest may result in business interruption, supply constraints, foreign currency devaluation, inflation, deflation or decreased demand. Economic conditions in North America could also

adversely impact growth. For example, rising fuel costs may impact the sales of our products in convenience stores where our products are generally sold in higher margin single serve packages.

**Our continued growth requires us to develop our leadership bench and to implement programs, such as our long-term incentive program, designed to retain talent.**

#### **Regulatory Environment**

Changes in laws, regulations and the related interpretations may alter the environment in which we do business and, therefore, impact our results or increase our liabilities. Such regulatory environment changes include changes in food and drug laws, laws related to advertising and deceptive marketing practices, accounting standards, taxation requirements, competition

laws and environmental laws, including the regulation of water consumption and treatment.

#### **Workforce Retention**

Our continued growth requires us to develop our leadership bench and to implement programs, such as our long-term incentive program, designed to retain talent. We also compete to hire new employees, and then must train them and develop their skills and competencies. We have in place human resource programs, including our diversity and inclusion focus mentioned by our chairman, aimed at hiring, developing and retaining our talented and motivated workforce which provides us with competitive advantage. However, unplanned turnover could deplete our institutional knowledge base and erode our competitive advantage.

#### **Market Risks**

**We are exposed to the market risks arising from adverse changes in:**

- commodity prices, affecting the cost of our raw materials and energy;
- foreign exchange rates;
- interest rates;
- stock prices; and
- discount rates, affecting the measurement of our pension and retiree medical liabilities.

In the normal course of business, we manage these risks through a variety of strategies, including productivity initiatives, global purchasing programs and hedging strategies. Ongoing productivity initiatives involve the identification of meaningful cost saving opportunities or efficiencies and effective implementation. Our global purchasing programs include fixed-price purchase orders and pricing agreements. Our hedging strategies involve the use of derivatives designated as cash flow and fair value

hedges. The fair value of our hedges fluctuates based on market rates and prices. The sensitivity of our hedges to these market fluctuations is discussed below. See Note 10 for further discussion of these hedges and our hedging policies. See "Our Critical Accounting Policies" for a discussion of the exposure of our pension plan assets and pension and retiree medical liabilities to risks related to stock prices and discount rates.

Inflationary, deflationary and recessionary conditions impacting these market risks also impact the demand for and pricing of our products. See "Product Demand and Retail Consolidation" and "Global Economic and Environmental Conditions" above for further discussion.

#### **Commodity Prices**

Our open commodity derivative contracts designated as hedges had a face value of \$155 million at December 25, 2004 and \$43 million at December 27, 2003. These derivatives resulted in a net unrealized loss of \$1 million at December 25, 2004 and \$4 million at December 27, 2003. We estimate that a 10% decline in commodity prices would have resulted in an unrealized loss of \$16 million in 2004 and \$1 million in 2003.

## Foreign Exchange

Financial statements of foreign subsidiaries are translated into U.S. dollars using period-end exchange rates for assets and liabilities and weighted-average exchange rates for revenues and expenses. Adjustments resulting from translating net assets are reported as a separate component of accumulated other comprehensive loss within shareholders' equity, called currency translation adjustment.

Our operations outside of the U.S. generate over a third of our net revenue of which Mexico, the United Kingdom and Canada comprise nearly 20%. As a result, we are exposed to foreign currency risks, including unforeseen economic changes and political unrest. During 2004, the impact of the favorable euro and British pound was partially offset by the unfavorable Mexican peso resulting in a contribution of almost 2 percentage points to revenue growth. If declines in the Mexican peso continue and are not offset, our future results will be adversely impacted.

Exchange rate gains or losses related to foreign currency transactions are recognized as transaction gains or losses in the income statement as incurred. We may enter into derivatives to manage our exposure to foreign currency transaction risk. Our foreign currency derivatives had a total face value of \$908 million at December 25, 2004 and \$484 million at December 27, 2003. These contracts had net unrealized losses of \$27 million at December 25, 2004 and \$30 million at December 27, 2003, respectively. We estimate that an unfavorable 10%

change in the exchange rates would have resulted in an unrealized loss of \$123 million in 2004 and \$50 million in 2003, respectively.

## Interest Rates

We centrally manage our debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. We may use interest rate and cross currency interest rate swaps to manage our overall interest expense and foreign exchange risk. These instruments effectively change the interest rate and currency of specific

**Our operations outside of the U.S. generate over a third of our net revenue of which Mexico, the United Kingdom and Canada comprise nearly 20%.**

debt issuances. These swaps are entered into concurrently with the issuance of the debt that they are intended to modify. The notional amount, interest payment and maturity date of the swaps match the principal, interest payment and maturity date of the related debt. Our counterparty credit risk is considered low because these swaps are entered into only with strong creditworthy counterparties, are generally settled on a net basis and are of relatively short duration.

Assuming year-end 2004 and 2003 variable rate debt and investment levels, a one point increase in interest rates would have decreased net interest expense by \$11 million in 2004 and \$10 million in 2003.

## Stock Prices

A portion of our deferred compensation liability is tied to certain market indices and our stock price. We manage these market risks with mutual fund investments and prepaid forward contracts for the purchase of our stock. The combined gains or losses on these investments are offset by changes in our deferred compensation liability, which are included in corporate selling, general and administrative expenses.

*We discuss expectations regarding our future performance, such as our business outlook, in our annual and quarterly reports, press releases, and other written and oral statements. These "forward-looking statements" are based on currently available competitive, financial and economic data and our operating plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from our expectations. The preceding discussion of risks is by no means all inclusive but is designed to highlight what we believe are important factors to consider when evaluating our trends and future results.*



# Our Critical Accounting Policies

An appreciation of our critical accounting policies is necessary to understand our financial results. These policies may require management to make difficult and subjective judgments regarding uncertainties, and as a result, such estimates may significantly impact our financial results. The precision of these estimates and the likelihood of future changes depend on a number of underlying variables and a range of possible outcomes. Other than our accounting for stock-based compensation and certain allocation methodologies for pension and retiree medical, our critical accounting policies do not involve the choice between alternative methods of accounting. We applied our critical accounting policies and estimation methods consistently in all periods presented and have discussed these policies with our Audit Committee.

Our critical accounting policies arise in conjunction with the following:

- revenue recognition,
- brand and goodwill valuations,
- income tax expense and accruals,
- stock-based compensation expense, and
- pension and retiree medical plans.

## Revenue Recognition

Our products are sold for cash or on credit terms. Our credit terms, which are established in accordance with local and industry practices, typically require payment within 30 days of delivery and may allow discounts for early payment. We recognize revenue upon shipment or delivery to our customers in accordance with written sales terms that do not allow for a right of return. However, our policy for DSD and chilled products is to remove and replace damaged and out-of-date products from store shelves to ensure that consumers receive the

**Our commitment to freshness and product dating serves to regulate the quantity of product shipped or delivered.**

product quality and freshness they expect. Similarly, our policy for warehouse distributed products is to replace damaged and out-of-date products. Based on our historical experience with this practice, we have reserved for anticipated damaged and out-of-date products. Our bottlers have a similar replacement policy and are responsible for the products they distribute.

Our policy is to provide customers with product when needed. In fact, our commitment to freshness and product dating serves to regulate the quantity of product shipped or delivered. In addition, DSD products are placed on the shelf by our employees with customer shelf space limiting the quantity of product. For product delivered through our other distribution networks, customer inventory levels are monitored.

As discussed in "Our Customers," we offer sales incentives through various programs to customers and consumers. Sales incentives are accounted for as a reduction of sales and totaled \$6.6 billion in 2004, \$6.0 billion in 2003 and \$5.5 billion in 2002. Sales incentives include payments to customers for performing merchandising activities on our behalf, such as payments for in-store displays, payments to gain distribution of new products, payments for shelf space, and discounts to promote lower retail prices. A number of our sales incentives, such as bottler funding and customer volume rebates, are based on annual targets, and accruals are established during the year for the expected payout. These accruals are based on our historical experience with similar programs and

require management judgment with respect to estimating customer participation and performance levels. The terms of most of our incentive arrangements do not exceed a year, and therefore do not require highly uncertain long-term estimates. For interim reporting, we estimate total annual sales incentives and record a pro rata share in proportion to revenue. Certain arrangements, including fountain pouring rights, may extend up to 15 years. The costs incurred to obtain these arrangements are recognized over the life of the contract as a reduction of revenue, and the outstanding balances of \$337 million at year-end 2004 and \$359 million at year-end 2003 are included in other assets in our Consolidated Balance Sheet.

We estimate and reserve for our bad debt exposure based on our experience with past due accounts. Our method of determining the reserves has been consistent during the years presented in the consolidated financial statements. Bad debt expense is classified within selling, general and administrative expenses in our Consolidated Statement of Income.

## Brand and Goodwill Valuations

We sell products under a number of brand names, many of which were developed by us. The brand development costs are expensed as incurred. We also purchase brands and goodwill in acquisitions. Upon acquisition, the purchase price is first allocated to identifiable assets and liabilities, including brands, based on estimated fair value, with any remaining purchase price recorded as goodwill.

We believe that a brand has an indefinite life if it has significant market share in a stable macroeconomic environment, and a history of strong revenue and cash flow performance that we expect to continue for the foreseeable future. If these perpetual brand criteria are not met, brands are amortized over their expected useful lives, which generally range from five to 20 years. Determining the expected life of a brand requires considerable management judgment and is based on an evaluation of a number of factors, including the competitive environment, market share, brand history and the macroeconomic environment of the countries in which the brand is sold.

Goodwill, including the goodwill that

is part of our noncontrolled bottling investment balances, and perpetual brands are not amortized. Perpetual brands and goodwill are assessed for impairment at least annually to ensure that discounted future cash flows continue to exceed the related book value. A perpetual brand is impaired if its book

**We did not recognize any impairment charges for perpetual brands or goodwill during the years presented.**

value exceeds its fair value. Goodwill is evaluated for impairment if the book value of its reporting unit exceeds its fair value. A reporting unit can be a division or business within a division. If the fair value of an evaluated asset is less than its book value, the asset is written down to fair value based on its discounted future cash flows.

Amortizable brands are only evaluated for impairment upon a significant change in the operating or macroeconomic environment. If an evaluation of the undiscounted cash flows indicates

impairment, the asset is written down to its estimated fair value, which is based on its discounted future cash flows.

Considerable management judgment is necessary to evaluate the impact of operating and macroeconomic changes and to estimate future cash flows. Assumptions used in our impairment evaluations, such as forecasted growth rates and our cost of capital, are consistent with our internal forecasts and operating plans. These assumptions could be adversely impacted by certain of the risks discussed in the "Our Business Risks" section, including, but not limited to, operating risks, product demand and the competitive landscape.

We did not recognize any impairment charges for perpetual brands or goodwill during the years presented. As of December 25, 2004, we had \$4.8 billion of perpetual brands and goodwill, of which nearly 75% related to Tropicana and Walkers. In our most recent impairment evaluations for Tropicana and Walkers, no impairment charges would have resulted even if the fair market values resulting from our discounted cash flow analyses were assumed to be 5% lower.

## Income Tax Expense and Accruals

In 2004, our annual tax rate for continuing operations was 24.7% compared to 28.5% in 2003 as discussed in "Other Consolidated Results." The tax rate in 2004 decreased 3.8 percentage points primarily as a result of the favorable resolution of certain open tax issues. For 2005, our annual tax rate is expected to be 29.4%, reflecting the absence of the favorable 2004 resolutions, and excluding any impact of the potential repatriation of certain undistributed international earnings discussed below and in Note 5.

Our annual tax rate is based on our income, statutory tax rates and tax planning opportunities available to us in the various jurisdictions in which we operate. Significant judgment is required in determining our annual tax rate and in evaluating our tax positions.

We establish reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are subject to challenge and that we may not succeed. We adjust these reserves, as

**Our annual tax rate for continuing operations was 24.7% in 2004 compared to 28.5% in 2003.**

well as the related interest, in light of changing facts and circumstances, such as the progress of a tax audit. An estimated effective tax rate for a year is applied to our quarterly operating results. In the event there is a significant or unusual item recognized in our

quarterly operating results, the tax attributable to that item is separately calculated and recorded at the same time as that item. We consider the tax benefits from the resolution of prior year tax matters to be such items.

Tax law requires items to be included in the tax return at different times than the items are reflected in the financial statements. As a result, our annual tax rate reflected in our financial statements is different than that reported in our tax return (our cash tax rate). Some of these differences are permanent, such as expenses that are not deductible in our tax return, and some differences reverse over time, such as depreciation expense. These temporary differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that

can be used as a tax deduction or credit in our tax return in future years for which we have already recorded the tax benefit in our income statement. We establish valuation allowances for our deferred tax assets when we believe expected future taxable income is not likely to support the use of a deduction or credit in that tax jurisdiction. Deferred tax liabilities generally represent tax expense recognized in our financial statements for which payment has been deferred, or expense for which we have already taken a deduction in our tax return but we have not yet recognized as expense in our financial statements.

We have not recognized any U.S. tax expense on undistributed international earnings since we intend to reinvest the earnings outside the U.S. for the foreseeable future, subject to the opportunity afforded us as a result of the American Jobs Creation Act of 2004 (AJCA). Our undistributed earnings are approximately \$11.9 billion at December 25, 2004, and \$8.8 billion at December 27, 2003. We are currently contemplating taking advan-

tage of the AJCA for up to \$7.5 billion of our undistributed foreign earnings. See Note 5 for further discussion on the AJCA and its potential impact on our 2005 results.

A number of years may elapse before a particular matter, for which we have established a reserve, is audited and finally resolved. The number of years with open tax audits varies depending on the tax jurisdiction. During 2004, we recognized \$266 million of tax benefits related to the favorable resolution of certain open tax issues. In addition, in 2004, we recognized a benefit of \$38 million upon agreement with the U.S. Internal Revenue Service (IRS) on an open issue related to our discontinued restaurant operations. At the end of 2003, we entered into agreements with the IRS for open years through 1997. These agreements resulted in a tax benefit of \$109 million in the fourth quarter of 2003. As part of these agreements, we also resolved the treatment of certain other issues related to future tax years.

The IRS has initiated their audits of our tax returns for the years 1998

through 2002. Our tax returns subsequent to 2002 have not yet been examined. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe that our reserves reflect the probable outcome of known tax contingencies. Settlement of any particular issue would usually require the use of cash. Favorable resolution would be recognized as a reduction to our annual tax rate in the year of resolution. Our tax reserves, covering all federal, state and foreign jurisdictions, are presented in the balance sheet within other liabilities (See Note 14), except for any amounts relating to items we expect to pay in the coming year which are included in current income taxes payable. For more information on the impact of the resolution of open tax issues, see "Other Consolidated Results" and "Our Liquidity, Capital Resources and Financial Position."

## Stock-Based Compensation Expense

We believe that we will achieve our best results if our employees act and are rewarded as business owners.

Therefore, we believe stock ownership and stock-based incentive awards are the best way to align the interests of employees with those of our shareholders. Historically, following competitive market practices, we have used stock option grants as our primary form of long-term incentive compensation. These grants are made at the current stock price, meaning each employee's exercise price is equivalent to our stock price on the date of grant. Employees must generally provide three additional years of service to earn the grant, referred to as the vesting period. Our options generally have a 10-year term, which means our employees would have up to seven years after the vesting period to elect to pay the exercise price to purchase one share of our stock for each option exercised. Employees

benefit from stock options to the extent our stock price appreciates above the exercise price after vesting and during the term of the grant. There have been no reductions to the exercise price of

**Our new executive compensation program, effective for 2004, strengthens the relationship between pay and individual performance.**

previously issued awards, and any repricing of awards would require approval of our shareholders.

Our new executive compensation program, effective for 2004, strengthens the relationship between pay and individual performance through greater differentiation in the amount of base pay, bonus and stock-based compensa-

tion based on an employee's responsibility and performance. The new program results in a shift of both cash and stock-based compensation to our top performing executives. In addition, our new program provides executives, who are awarded long-term incentives based on their performance, with a choice of stock options or restricted stock units (RSUs). RSUs generally vest after three years of service and each restricted stock unit can be settled in a share of our stock after the vesting period. Executives who elect RSUs receive one RSU for every four stock options that would have otherwise been granted. Senior officers do not have a choice and are granted 50% stock options and 50% RSUs. Vesting of RSU awards for senior officers is contingent upon the achievement of pre-established performance targets.



We also continued, as we have since 1989, to grant an annual award of stock options to all eligible employees, based on job level or classification under our broad-based stock option program, SharePower. As part of the new compensation program in 2004, the SharePower program grant was reduced by approximately 50% for employees in the U.S. and replaced with matching contributions of PepsiCo stock to our 401(k) savings plans. We did not reduce the SharePower award for international employees and continued using tenure as a base for delivering the award in addition to job level and classification. For additional information on our 401(k) savings plans, see Note 7.

#### Method of Accounting

We account for our employee stock options under the fair value method of accounting using a Black-Scholes valuation model to measure stock-based compensation expense at the date of grant. We do not expect Statement of Financial Accounting Standards (SFAS) 123R, *Share-Based Payment*, to materially impact our financial statements upon adoption no later than in the fourth quarter of 2005. Two of our anchor bottlers, PBG and PAS, will be adopting SFAS 123R in 2005. They are currently evaluating the impact of SFAS 123R which will consequently impact our bottling equity income.

Beginning in 2004, our divisions were held accountable for stock-based

compensation expense and, therefore, this expense is allocated to our divisions as an incremental employee compensation cost. Prior year division results have been adjusted for comparability. The allocation of compensation expense is approximately 28% FLNA, 19% PBNA, 32% PI, 4% QFNA and 17% corporate unallocated. The expense allocated to our divisions excludes any impact of changes in our Black-Scholes assumptions which reflect market conditions over which division management has no control. Therefore, any variances between allocated expense and our actual expense are recognized in corporate unallocated expenses.

#### Our Assumptions

	2005	2004	2003	2002
Expected life	6 yrs.	6 yrs.	6 yrs.	6 yrs.
Risk free interest rate	3.8%	3.3%	3.1%	4.4%
Expected volatility	22%	26%	27%	27%
Expected dividend yield	1.8%	1.8%	1.15%	1.14%

Our Black-Scholes model estimates the expected value our employees will receive from the options based on a number of assumptions, such as interest rates, employee exercises, our stock price and dividend yield. The table above includes our weighted-average fair value assumptions.

The expected life is a significant assumption as it determines the period for which the risk free interest rate, volatility and dividend yield must be applied. The expected life is the period over which our employee groups are expected to hold their options. It is based on our historical experience with similar grants. The risk free interest rate is based on the expected U.S. Treasury rate over the expected life. Volatility reflects movements in our stock price over the most recent historical period equivalent to the expected life. Dividend yield is estimated over the expected life based on our stated dividend policy and forecasts of net income, share repurchases and stock price.

#### 2005 Estimated Expense and Sensitivity of Assumptions

Our stock-based compensation expense, including RSUs, is as follows:

	Estimated 2005	2004	2003
Stock-based compensation expense	\$320	\$368	\$407

If we assumed a 100 basis point change in the following assumptions, our estimated 2005 stock-based compensation expense would increase/(decrease) as follows:

	100 Basis Point Increase	100 Basis Point Decrease
Risk free interest rate	\$ 4	\$(4)
Expected volatility	\$ 1	\$(1)
Expected dividend yield	\$(6)	\$ 7

If the expected life were assumed to be one year longer, our estimated 2005 stock-based compensation expense would increase by \$9 million. If the expected life were assumed to be one year shorter, our estimated 2005 stock-based compensation expense would decrease by \$6 million. As noted, changing the assumed expected life impacts all of the Black-Scholes valuation assumptions as the risk free interest rate, expected volatility and expected dividend yield are estimated over the expected life.

## Pension and Retiree Medical Plans

Our pension plans cover full-time employees in the U.S. and certain international employees. Benefits are determined based on either years of service or a combination of years of service and earnings. U.S. retirees are also eligible for medical and life insurance benefits (retiree medical) if they meet age and service requirements. Generally, our share of retiree medical costs is capped at specified dollar amounts, which vary based upon years of service, with retirees contributing the remainder up to the total cost.

### Our Assumptions

The pension or retiree medical benefits expected to be paid are expensed over the employees' expected service. We must make many assumptions to measure our annual pension and retiree medical expense, including:

- the interest rate used to determine the present value of liabilities (discount rate);
- the expected return on assets in our funded plans;
- the rate of salary increases for plans where benefits are based on earnings;
- certain employee-related factors, such as turnover, retirement age and mortality; and
- for retiree medical benefits, health care cost trend rates.

The assumptions, assets and liabilities used to measure our annual pension and retiree medical expense are

determined as of September 30 (measurement date) and all plan assets and liabilities are reported as of that date. Our assumptions reflect our historical experience and management's best judgment regarding future expectations. Some of these assumptions require significant management judgment and could have a material impact on the measurement of our pension and retiree medical benefit expense and obligation. However, any impact from the changes in retiree medical assumptions would be mitigated by the cap on these benefits.

**Our 2005 pension expense is estimated to be approximately \$310 million and retiree medical expense is estimated to be approximately \$135 million.**

Since pension and retiree medical liabilities are measured on a discounted basis, the discount rate is a significant assumption. At each measurement date, the discount rate is based on interest rates for high-quality, long-term corporate debt securities with maturities comparable to our liabilities. The expected return on pension plan assets is based on our historical experience, our pension plan investment strategy, and our expectations for long-term rates of return. Our pension plan investment strategy is reviewed annually and is based upon plan liabilities, an evaluation of market conditions,

tolerance for risk and cash requirements for benefit payments. We use a third-party consultant to assist us in determining our investment allocation and modeling our long-term rate assumptions. Our current investment allocation target for our U.S. plans is 60% equity securities, with the balance in fixed income securities. Our current assumed rate of return on plan assets is 7.8%, reflecting an estimated long-term return of 9.3% from equity securities and an estimated 5.8% from fixed income securities. As permitted by U.S. generally accepted accounting principles, plan assets used in determining the expected return component of annual pension expense reflect the difference between the actual and the expected return in any one year over five years. Therefore, it takes five years for the gain or loss from any one year to be fully included in the measurement of plan assets.

Other gains and losses resulting from actual experience differing from our assumptions are also determined at each measurement date. If this net accumulated gain or loss exceeds 10% of the greater of plan assets or liabilities, a portion of the net gain or loss is included in expense for the following year. The cost or benefit of plan changes, such as increasing or decreasing benefits for prior employee service, is included in expense on a straight-line basis over the average remaining service period of the employees expected to receive benefits.

Weighted-average assumptions for pension and retiree medical expense are the following:

	2005	2004	2003
<b>Pension</b>			
Expense discount rate	6.1%	6.1%	6.7%
Expected rate of return on plan assets	7.8%	7.8%	8.2%
Expected rate of salary increases	4.3%	4.4%	4.4%
<b>Retiree medical</b>			
Expense discount rate	6.1%	6.1%	6.7%
Current health care cost trend rate	11.0%	12.0%	10.0%

## Future Expense

Our 2005 pension expense is estimated to be approximately \$310 million and retiree medical expense is estimated to be approximately \$135 million. These estimates incorporate the 2005 assumptions, as well as the impact of the increased pension plan assets resulting from our discretionary contributions of \$400 million in 2004, and the impact of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) as discussed in Note 7. Changes in our

2005 assumptions include updates to our mortality tables, employee turnover assumptions, and retirement age assumptions. These changes result in an increase in our pension experience loss amortization for 2005 of \$45 million. In addition, the increase in amortization for 2005 pension expense reflects the absence of asset gain amortization of approximately \$50 million in 2004 in accordance with our methodology discussed above. An analysis of the estimated change in pension and retiree medical expense follows:

	Pension	Retiree Medical
2004 expense	\$245	\$121
Increase in experience loss amortization	100	21
Impact of funding	(36)	—
Increase in prior service benefit amortization	(3)	(4)
Other, including impact of 2003 Medicare Act	4	(3)
2005 estimated expense	\$310	\$135

Pension service costs, including the impact of demographic assumption changes on service costs, are reflected in division results, with the impact of changes in discount and asset return rates, gains and losses, and the impact of funding reflected in corporate unallocated. Under this policy, approximately \$20 million of the increased pension and retiree medical expense in 2005 will be reflected in corporate unallocated expense.

Based on our current assumptions, which reflect our prior experience and current plan provisions, and assuming we are allowed to make annual discretionary contributions of approximately \$400 million, we expect our pension expense to increase by approximately \$15 million in 2006. In 2007, our pension expense would begin to decrease, with the expense dropping to approximately \$220 million by 2010 as unrecognized asset losses are fully amortized. If our assumptions and our plan provisions for retiree medical

remain unchanged and our experience mirrors these assumptions, we expect our annual retiree medical expense beyond 2005 to approximate \$140 million.

## Sensitivity of Assumptions

A decrease in the discount rate or a decrease in the expected rate of return on assets would increase pension expense. The estimated impact of a 25 basis point change in the discount rate on 2005 pension expense is a change of approximately \$32 million. The estimated impact on 2005 pension expense of a 25 basis point change in the expected rate of return on assets is a change of approximately \$13 million. See Note 7 regarding the sensitivity of our retiree medical cost assumptions.

## Future Funding

We make contributions to pension trusts maintained to provide plan benefits for certain pension plans. These contributions are made in accordance

- In 2005, we expect contributions to be about the same as 2004 with approximately \$400 million expected to be discretionary.
- Our cash payments for retiree medical are estimated to be \$85 million in 2005.

with applicable tax regulations that provide for current tax deductions for our contributions, and taxation to the employee only upon receipt of plan benefits. Generally, we do not fund our pension plans when our contributions would not be currently deductible or when the employee would be taxed prior to receipt of benefit.

Our pension contributions for 2004 were \$458 million of which \$400 million was discretionary. In 2005, we expect contributions to be about the same with approximately \$400 million expected to be discretionary and the remainder satisfying minimum requirements. Our cash payments for retiree medical are estimated to be \$85 million in 2005. As our retiree medical plans are not subject to regulatory funding requirements, we fund these plans on a pay-as-you-go basis. For estimated future benefit payments, including our pay-as-you-go payments as well as those from trusts, see Note 7.



# Our Financial Results

## Items Affecting Comparability

The year-over-year comparisons of our financial results are affected by the following items:

	2004	2003
<b>Operating profit</b>		
Impairment and restructuring charges.....	\$(150)	\$(147)
Merger-related costs.....	—	\$(59)
<b>Net income</b>		
Impairment and restructuring charges.....	\$(96)	\$(100)
Merger-related costs.....	—	\$(42)
Net tax benefits — continuing operations.....	\$266	\$109
Tax benefit from discontinued operations.....	\$38	—
<b>Net income per common share — diluted</b>		
Impairment and restructuring charges.....	\$(0.06)	\$(0.06)
Merger-related costs.....	—	\$(0.02)
Net tax benefits — continuing operations.....	\$0.15	\$0.06
Tax benefit from discontinued operations.....	\$0.02	—

For the items and accounting changes affecting our 2002 results, see Note 1 and our 2002 Annual Report.

### Impairment and Restructuring Charges and Merger-Related Costs

In the fourth quarter of 2004, we incurred restructuring and impairment charges of \$150 million in conjunction with the consolidation of FLNA's manufacturing network in connection with its ongoing productivity program. Savings from this productivity program have been and are expected to be used to offset increased marketplace spending.

In the fourth quarter of 2003, we incurred a restructuring charge of \$147 million in conjunction with the streamlining of our North American divisions and PepsiCo International. Also, during 2003 and in 2002, we incurred costs associated with our merger with The Quaker Oats Company (Quaker).

For additional information, see Note 3.

### Net Tax Benefits — Continuing Operations

In the fourth quarter of 2004, we recognized \$45 million of tax benefits related to the completion of the IRS audit for pre-merger Quaker open tax years. In the third quarter of 2004, we recognized \$221 million of tax benefits related to a reduction in foreign tax accruals following the resolution of certain open tax issues with foreign tax authorities, and a refund claim related to prior U.S. tax settlements.

At the end of 2003, we entered into agreements with the IRS for open tax years through 1997. These agreements resulted in a tax benefit of \$109 million. As part of these agreements, we also resolved the treatment of certain other issues related to future tax years.

For additional information, see "Our Critical Accounting Policies."

### Tax Benefit from Discontinued Operations

In the fourth quarter of 2004, we reached agreement with the IRS for an open issue related to our discontinued restaurant operations which resulted in a tax benefit of \$38 million.

# Results of Continuing Operations — Consolidated Review

In the discussions of net revenue and operating profit below, effective net pricing reflects the year-over-year impact of discrete pricing actions, sales incentive activities and mix resulting from selling varying products in different package sizes and in different countries.

## Servings

Since our divisions each use different measures of physical unit volume (i.e., kilos, pounds and case sales), a common servings metric is necessary to reflect our consolidated physical unit volume. Our divisions' physical volume measures are converted into servings based on U.S. Food and Drug Administration guidelines for single-serving sizes of our products.

Total servings increased 6% in 2004 compared to 2003 as servings for beverages worldwide grew 7% and servings for snacks worldwide grew over 5%. All of our divisions positively contributed to the total servings growth. Total servings increased 5% in 2003 compared to 2002 primarily due to contributions from PI, PBNA and FLNA.

## Net Revenue and Operating Profit

### 2004

Division net revenue increased 8%, primarily due to strong volume gains across all divisions, favorable product mix, primarily at PBNA and PI, and net favorable foreign currency movements. The volume gains contributed over 4 percentage points, the favorable mix contributed almost 2 percentage points, and the net favorable foreign currency contributed almost 2 percentage points to division net revenue growth.

Total operating profit increased 10% and margin increased 0.3 percentage points. Division operating profit increased 12% and division margin increased 0.5 percentage points. These gains reflect leverage from the revenue growth, partially offset by increased selling, general and administrative expenses, primarily corporate unallocated expenses. In addition, total operating profit growth reflects the absence of merger-related costs in 2004.

### 2003

Net revenue increased 7%. Division net revenue increased 8%, primarily due to the strong volume which

	Change				
	2004	2003	2002	2004	2003
Division net revenues	\$29,261	\$26,969	\$24,978	8%	8%
Divested businesses	—	2	134		
Total net revenue	\$29,261	\$26,971	\$25,112	8%	7%
Division operating profit	\$6,098	\$5,463	\$4,934	12%	11%
Corporate unallocated	(689)	(502)	(438)	38%	14%
Merger-related costs	—	(59)	(224)		
Impairment & restructuring charges	(150)	(147)	—		
Divested businesses	—	26	23		
Total operating profit	\$5,259	\$4,781	\$4,295	10%	11%
Division operating profit margin	20.8%	20.3%	19.8%	0.5	0.5
Total operating profit margin	18.0%	17.7%	17.1%	0.3	0.6

contributed 4 percentage points of growth. Favorable product and country mix, as well as North American snack and concentrate price increases, contributed over 2 percentage points to the growth. Favorable foreign currency movements contributed nearly 1 percentage point to the net revenue growth.

Total operating profit increased 11% and margin increased 0.6 percentage points. Division operating profit

increased 11% and division margin increased 0.5 percentage points. These gains were driven by the strong volume and higher effective net pricing. Cost of sales increased 8%, reflecting increased commodity costs, particularly corn oil and natural gas. Selling, general and administrative expenses increased 6% driven by higher selling costs primarily reflecting the increased volume and increased fuel costs. Unfavorable foreign currency reduced

operating profit growth by nearly 1 percentage point. In addition, total operating profit reflects the benefit from lower merger-related costs, offset by the 2003 impairment and restructuring charges of \$147 million.

#### Corporate Unallocated Expenses

Corporate unallocated expenses include the costs of our corporate headquarters, centrally managed initiatives such as our BPT initiative, unallocated insurance and benefit programs, foreign exchange transaction gains and losses, profit-in-inventory elimination adjustments for our noncontrolled bottling affiliates, and certain other items.

In 2004, corporate unallocated expenses increased 38%. Higher employee-related costs contributed 18 percentage points of the increase, an accrual recognized in the fourth quarter for the settlement of a contractual dispute with a former business partner represented 10 percentage points of the increase, and higher costs related to our BPT initiative contributed 4 percentage points of the increase. Corporate departmental expenses increased 2% compared to prior year.

In 2003, corporate unallocated expenses increased 14% primarily reflecting our 2003 investment in our BPT initiative. Higher employee-related costs, including deferred compensation, and corporate departmental costs also contributed to the increase. The increase in the deferred compensation costs is partially offset by the decrease in net interest expense. Corporate departmental expenses increased 3% reflecting staffing and other costs related to our health and wellness initiatives.

## Other Consolidated Results

Bottling equity income includes our share of the net income or loss of our noncontrolled bottling affiliates as described in "Our Customers." Our interest in these bottling investments may change from time to time. Any gains or losses from these changes, as well as other transactions related to our bottling investments, are also included on a pre-tax basis. Over time, we expect to be selling shares of PBG stock to trim our ownership to the level at the time of PBG's initial public offering. Our ownership has increased as a result of PBG's share repurchase program. During 2005, we intend to sell up to 7.5 million shares of PBG stock. The resulting lower ownership percentage will reduce the equity income from PBG that we recognize.

#### 2004

Bottling equity income increased 18%, primarily reflecting increased earnings from our anchor bottlers and favorable comparisons from international bottling investments, primarily as a result of the nationwide strike in Venezuela in early 2003.

Net interest expense declined 17% primarily due to favorable interest rates and higher average cash balances,

partially offset by higher average debt balances and lower gains in the market value of investments used to economically hedge a portion of our deferred compensation liability. The offsetting increase in deferred compensation costs is reported in corporate unallocated expenses within selling, general and administrative expenses.

The annual tax rate decreased 3.8 percentage points compared to the prior year, primarily as a result of tax benefits from the resolution of open items with tax authorities in both years, as discussed in "Items Affecting Comparability." The tax benefits reduced our tax rate by 2.6 percentage points. Increased benefit from concentrate operations and favorable changes arising from agreements with the Internal Revenue Service in the fourth quarter of 2003 also contributed to the decline in rate.

Net income from continuing operations increased 17% and the related net income per common share from continuing operations increased 18%. These increases primarily reflect the solid operating profit growth and our lower annual tax rate. The absence of merger-related costs in 2004 and increased bottling equity income also contributed to the growth.

#### 2003

Bottling equity income increased 16%. This increase primarily reflects a favorable comparison to the impairment charge taken in 2002 on a Latin American bottling investment, and increased earnings from PBG and PAS in 2003.

Net interest expense declined 21% primarily due to a gain of \$22 million on investments used to economically hedge a portion of our deferred

	Change				
	2004	2003	2002	2004	2003
Bottling equity income	\$380	\$323	\$280	18%	16%
Interest expense, net	\$(93)	\$(112)	\$(142)	(17)%	(21)%
Annual tax rate	24.7%	28.5%	32.3%		
Net income — continuing operations	\$4,174	\$3,568	\$3,000	17%	19%
Net income per common share — continuing operations — diluted	\$2.41	\$2.05	\$1.68	18%	22%



compensation liability versus losses of \$18 million in the prior year. This net gain was partially offset by lower investment rates.

The annual tax rate decreased 3.8 percentage points compared to the prior year. At the end of 2003, we entered into agreements with the IRS. These agreements resulted in a tax benefit of \$109 million, reducing our tax rate by over 2 percentage points. Lower taxes

on foreign results, including the impact of our new concentrate operations, also reduced our tax rate by nearly 2 percentage points. The impact of lower nondeductible merger-related costs contributed 0.9 percentage points to the decrease.

Net income increased 19% and the related net income per common share increased 22%. These increases primarily reflect the solid operating

profit growth, our lower annual tax rate and increased bottling equity income. The benefit of lower merger-related costs was largely offset by the impairment and restructuring charges. Net income per common share also reflects the benefit of a reduction in average shares outstanding primarily as a result of share repurchase activity.

## Results of Continuing Operations — Division Review

The results and discussions below are based on how our Chief Executive Officer monitors the performance of our divisions. Prior year amounts exclude the results of divested businesses. For additional information on these items and our divisions, see Note 1.

	FLNA	PBNA	PI	QFNA	Divested Businesses	Total
Net Revenue, 2004	\$9,560	\$8,313	\$9,862	\$1,526	—	\$29,261
Net Revenue, 2003	\$9,091	\$7,733	\$8,678	\$1,467	\$2	\$26,971

<i>% Impact of:</i>						
Volume	3%	3%	7%	3%	—	4%
Effective net pricing	2	4	2	—	—	2
Foreign exchange	—	—	4	1	—	2
Acquisition/divestitures	—	—	1	—	—	—
% Change	5%	7%	14%	4%	N/A	8%

	FLNA	PBNA	PI	QFNA	Divested Businesses	Total
Net Revenue, 2003	\$9,091	\$7,733	\$8,678	\$1,467	\$2	\$26,971
Net Revenue, 2002	\$8,565	\$7,200	\$7,749	\$1,464	\$134	\$25,112

<i>% Impact of:</i>						
Volume	4%	3%	7%	—	—	4%
Effective net pricing	2	4	2	—	—	2
Foreign exchange	1	1	1	1	—	1
Acquisition/divestitures	—	—	2	—	—	—
% Change	6%	7%	12%	—	N/A	7%

## Frito-Lay North America

	% Change				
	2004	2003	2002	2004	2003
Net revenue	\$9,560	\$9,091	\$8,565	5	6
Operating profit	\$2,389	\$2,242	\$2,081	7	8

### 2004

Net revenue grew 5% reflecting volume growth of 3% and positive effective net pricing due to salty snack pricing actions and favorable mix. Pound volume grew primarily due to new products, single-digit growth in Lay's Classic potato chips, strong double-digit growth in Variety Pack, and mid single-digit growth in Tostitos and Fried Cheetos. Lay's Stax and Doritos Rollitos led the new product growth. These gains were partially offset by single-digit declines in Doritos and Fritos, and double-digit declines in Rold Gold and Quaker Toastables.

Operating profit grew nearly 7% reflecting the positive pricing actions and volume growth. Higher commodity costs, driven by corn oil and energy costs were largely offset by cost leverage generated from ongoing productivity initiatives.

On September 1, 2004, we introduced our new "Smart Spot" program which helps consumers identify products in our portfolio that

can contribute to a healthier lifestyle. Products qualifying for our new Smart Spot program represented approximately 10% of 2004 FLNA net revenue. These products experienced high single-digit revenue growth and the balance of the portfolio had mid single-digit revenue growth. See our website at [www.smartspot.com](http://www.smartspot.com) for additional information on our new Smart Spot program.

**FLNA volume grew 3% and 4% in 2004 and 2003, respectively.**

### 2003

Net revenue growth of 6% reflects volume growth of 4% and positive effective net pricing. Pound volume grew primarily due to new products, double-digit growth in Cheetos, Munchies snack mix and Quaker Chewy Granola bars, and single-digit growth in branded dips and

Doritos. Quaker Toastables, Lay's Stax and the Natural snack line led the new product growth. These gains were partially offset by double-digit declines in Rold Gold, Lay's Bistro, and Go Snacks. Modest pricing actions on certain salty snacks and favorable mix led the positive effective net pricing. These gains were partially offset by higher trade spending on product innovation.

Operating profit growth of 8% reflects the volume growth and positive effective net pricing. These gains were partially offset by increased commodity costs, particularly corn oil and natural gas. Increased commodity costs reduced operating profit growth by 3 percentage points, more than offsetting the cost leverage generated from productivity initiatives.

# PepsiCo Beverages North America

	% Change				
	2004	2003	2002	2004	2003
Net revenue	\$8,313	\$7,733	\$7,200	7	7
Operating profit	\$1,911	\$1,690	\$1,485	13	14

## 2004

Net revenue increased 7% and volume increased 3%. The volume increase reflects non-carbonated beverage growth of 10% and a slight increase in carbonated soft drinks (CSDs). The non-carbonated beverage growth was fueled by double-digit growth in Gatorade, Aquafina and Propel, as well as the introduction of bottled-distributed Tropicana juice drinks.

### Beverage volume increased 3% in 2004 driven by non-carbonated beverage growth of 10%.

Tropicana Pure Premium increased slightly for the year. The carbonated soft drink performance reflects a low single-digit increase in Trademark Mountain Dew and a slight increase in Trademark Sierra Mist, offset by a slight decline in Trademark Pepsi. Across the trademarks, high single-digit diet CSD growth was substantially offset by a low single-digit decline in regular CSDs. The increase in Trademark Mountain Dew reflects growth in both Diet and regular Mountain Dew and the limited time only offering of Mountain Dew Pitch Black, substantially offset by

declines in both Mountain Dew Code Red and LiveWire. The performance of Trademark Pepsi reflects declines in regular Pepsi, Pepsi Twist and Pepsi Blue, mostly offset by increases in Diet Pepsi and the introduction of Pepsi Edge. Favorable product mix contributed 3 percentage points to net revenue growth, primarily reflecting a migration to non-carbonated beverages. Additionally, concentrate and fountain price increases taken in the first quarter contributed 1 percentage point to net revenue growth.

Operating profit increased 13% reflecting the net revenue growth, partially offset by higher selling, general and administrative costs, as well as costs related to marketplace initiatives.

Products qualifying for our new Smart Spot program represented over 60% of net revenue. These products experienced high single-digit revenue growth, and the balance of the portfolio had mid single-digit revenue growth.

## 2003

Net revenue increased 7% on volume growth of 3%. The volume growth reflects non-carbonated growth of 8% and carbonated beverage growth of 1.5%. Double-digit growth in Gatorade, Aquafina and Propel drove the non-carbonated portfolio. Tropicana chilled products growth was low single-digit. The carbonated beverage performance

reflects the national launch of Sierra Mist and high single-digit growth in diet carbonated beverages, primarily Diet Pepsi. Declines in trademark Pepsi, excluding diet, partially offset this carbonated beverage growth. Higher effective net pricing contributed 4 percentage points to the net revenue growth. The higher effective net pricing reflects a favorable product mix shift to the higher priced non-carbonated beverages, and fountain and concentrate price increases, partially offset by increased promotional spending. The price increases contributed 1 percentage point to the net revenue growth.

Operating profit increased 14 percentage points reflecting the higher effective net pricing, volume gains and purchasing efficiencies. These gains were partially offset by increased advertising and marketing expenses. The higher effective net pricing contributed 9 percentage points to the operating profit growth with product mix contributing 7 percentage points.



	% Change				
	2004	2003	2002	2004	2003
Net revenue	\$9,862	\$8,678	\$7,749	14	12
Operating profit	\$1,323	\$1,061	\$910	25	17

## 2004

International snacks volume grew 8%, comprised of 7% in our Latin America region, 8% in our Europe, Middle East & Africa region and 14% in our Asia Pacific region. These gains were driven by high single-digit growth at Sabritas in Mexico, strong double-digit growth in India, low single-digit growth at Gamesa in Mexico coupled with double-digit growth in Egypt, Venezuela, Turkey and Brazil.

Beverage volume grew 12%, comprised of 14% in our Europe, Middle East & Africa region, 15% in our Asia Pacific region and 8% in our Latin America region. Broad-based increases were led by double-digit growth in the Middle East and China, high single-digit growth in Mexico and double-digit growth in India, Germany, Russia and Venezuela. Favorable comparisons as a result of the 2003 national strike in Venezuela and the German deposit law impact contributed to the growth in Venezuela and Germany. Both carbonated soft drinks and non-carbonated beverages grew at double-digit rates.

Net revenue grew 14% driven by the broad-based volume growth and favorable mix. Foreign currency impact contributed 4 percentage points of growth driven by the favorable British pound and euro, partially offset by the unfavorable Mexican peso. Acquisitions contributed less than 1 percentage point.

Operating profit grew 25% driven largely by the volume and favorable mix. The favorable comparison of certain reserve actions taken in 2003 on potentially unrecoverable beverage assets contributed 2 percentage points of growth. Foreign currency impact contributed almost 3 percentage points of growth driven by the favorable British pound and euro, partially offset by the unfavorable Mexican peso.

**In 2004, PI revenue grew 14% making it our largest division.**

## 2003

International snacks volume grew 6%, comprised of 3% in our Latin America region, 10% in our Europe, Middle East and Africa region and 16% in our Asia Pacific region. These gains were driven by double-digit growth from Walkers in the United Kingdom, India, Turkey and Russia, and low single-digit growth at Sabritas in Mexico. Mid single-digit sweet growth was led by Gamesa in Mexico.

Beverage volume grew 8%, comprised of 8% in our Latin America region, 6% in our Europe, Middle East and Africa region and 11% in our Asia Pacific region. Broad-based increases were led by double-digit growth in the

Middle East, China, Brazil, India, Russia and Thailand and mid single-digit growth in Mexico. Volume gains in India driven by competitive pricing actions were offset by double-digit declines in Germany due to the new one-way bottle deposit requirement imposed by the government.

Net revenue grew 12% driven by higher volume across most markets. Acquisitions contributed nearly 2 percentage points of growth and favorable foreign currency contributed 1 percentage point as the favorable euro and British pound substantially offset the unfavorable Mexican peso. These gains were partially offset by the impact of the German one-way beverage deposits and competitive beverage pricing actions in India.

Operating profit grew 17% largely due to the drivers of net revenue growth. Acquisitions contributed 2 percentage points of growth. Unfavorable foreign currency reduced operating profit by 6 percentage points due to the impact of the peso on our Mexican snack businesses. In addition, operating profits were reduced by 2 percentage points due to reserve actions taken on potentially unrecoverable beverage assets.

## Quaker Foods North America

	% Change				
	2004	2003	2002	2004	2003
Net revenue	\$1,526	\$1,467	\$1,464	4	—
Operating profit	\$475	\$470	\$458	1	3

### 2004

Net revenue increased 4% and volume increased 3%. The volume increase reflects high single-digit growth in Oatmeal and double-digit growth in Life cereal, partially offset by a mid single-digit decline in Cap'n Crunch cereal. The Life cereal growth was led by the introduction of Honey Graham Life. Favorable product mix, reflecting growth in higher revenue per pound brands, was offset by promotional spending behind new products. Favorable Canadian exchange rates contributed 1 percentage point to net revenue growth.

Operating profit increased 1% reflecting the net revenue growth, substantially offset by an unfavorable cost of sales comparison and higher advertising and marketing costs. Products

qualifying for our new Smart Spot program represented approximately half of net revenue and had high single-digit revenue growth. The balance of the portfolio was flat.

**In 2004, QFNA volume grew 3% driven by strong performance in oatmeal and Life cereal.**

### 2003

Net revenue and volume were flat compared to prior year as the national launch of Breakfast Squares and Canadian Oatmeal to Go growth were offset by declines in Rice and Pasta Roni side dishes and in our hot cereal

business. A favorable Canadian exchange rate, which contributed 1 percentage point to net revenue growth, and ready-to-eat cereal price increases, were offset by unfavorable product mix and increased promotional spending related to the Breakfast Squares launch.

Operating profit grew 3% compared to prior year. Lower advertising and marketing spending contributed over 4 percentage points to operating profit growth, while favorable cost of sales contributed almost 5 percentage points. These gains were partially offset by an unfavorable product mix, which reduced operating profit growth by 7 percentage points. The unfavorable product mix reflects declines in higher margin products.

# Our Liquidity, Capital Resources and Financial Position

Our strong cash-generating capability and financial condition give us ready access to capital markets throughout the world. Our principal source of liquidity is our operating cash flow. This cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating, investing and financing needs. In addition, we have revolving credit facilities that are further discussed in Note 9. Our cash provided from operating activities is somewhat impacted by seasonality. Working capital needs are impacted by weekly sales, which are generally highest in the third quarter due to seasonal and holiday-related sales patterns, and generally lowest in the first quarter.

## Operating Activities

In 2004, our operations provided \$5.1 billion of cash, primarily reflecting our solid business results, partially offset by net tax payments of \$1.8 billion and pension plan contributions of \$458 million of which \$400 million was discretionary. In 2003, our operations provided \$4.3 billion of cash reflecting our solid business results, partially offset by net tax payments of \$1.5 billion and pension plan contributions of \$535 million of which \$500 million was discretionary. The year-over-year increase in cash flows from operations is primarily attributable to our solid business results and effective working capital management, partially offset by the higher tax payments in 2004.

## Investing Activities

In 2004, we used \$2.3 billion for investing, primarily reflecting capital spending of \$1.4 billion and short-term investments of almost \$1.0 billion. In 2003, we used \$2.3 billion for investing, primarily reflecting capital spending of \$1.3 billion and short-term investments of nearly \$1.0 billion.

We expect capital spending to continue at a rate of approximately 5% of net revenue in 2005. In December 2004, we announced that we would acquire General Mills, Inc.'s 40.5% ownership interest in Snack Ventures Europe (SVE) for \$750 million. The transaction was completed in February 2005 and funded with existing international cash. In addition, in 2005, we will generate cash from the expected sale of up to 7.5 million shares of PBG stock.

## Financing Activities

In 2004, we used \$2.3 billion for financing, primarily reflecting share repurchases at a cost of \$3.0 billion and dividend payments of \$1.3 billion, partially offset by net issuances of short-term borrowings of \$1.1 billion and proceeds from exercises of stock options of nearly \$1.0 billion. This compares to \$2.9 billion used for financing in 2003, primarily reflecting share repurchases at a cost of \$1.9 billion and dividend payments of \$1.1 billion.

In the second quarter of 2004, our Board of Directors authorized a new

2004 Cash Utilization



\$7.0 billion share repurchase program. Since inception of the new program, we have repurchased \$2.1 billion of shares, leaving \$4.9 billion of remaining authorization. We target an annual dividend payout of approximately 45% of prior year's net income from continuing operations. Each spring we review our capital structure with our Board, including our dividend policy and share repurchase activity.

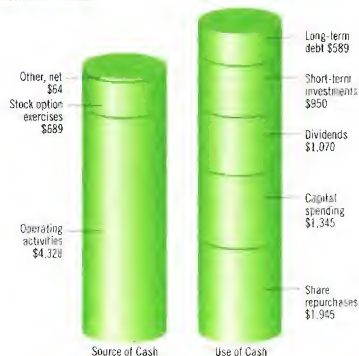
## Management Operating Cash Flow

We focus on management operating cash flow as a key element in achieving maximum shareholder value, and it is the primary measure we use to monitor cash flow performance. However, it is not a measure provided by accounting principles generally accepted in the U.S. Since net capital spending is essential to our product innovation initiatives and maintaining our operational capabilities, we believe that it is a recurring and necessary use of cash. As such, we believe investors should also consider net capital spending when evaluating our cash from operating activities. The table to the left reconciles the net cash provided by operating activities as reflected in our Consolidated Statement of Cash Flows to our management operating cash flow.

	2004	2003	2002
Net cash provided by operating activities	\$ 5,054	\$ 4,328	\$ 4,627
Capital spending	(1,387)	(1,345)	(1,437)
Sales of property, plant and equipment	38	49	89
Management operating cash flow	\$ 3,705	\$ 3,032	\$ 3,279



### 2003 Cash Utilization



### 2002 Cash Utilization



Management operating cash flow was used primarily to repurchase shares and pay dividends. We expect management operating cash flow in 2005 to exceed \$4.1 billion reflecting our underlying business growth. We expect to continue to return approximately all of our management operating cash flow to our shareholders through dividends and share repurchases, and expect our share repurchases to range from \$2.5 billion to \$3.0 billion in 2005. However, see "Our Business Risks" for certain factors that may impact our operating cash flows.

### Credit Ratings

Our debt ratings of Aa3 from Moody's and A+ from Standard & Poor's contribute to our ability to access global capital markets. We have maintained strong investment grade ratings for over a decade. Moody's rating reflects an upgrade from A1 to Aa3 in 2004 due to the strength of our balance sheet and cash flows. Each rating is considered strong investment

grade and is in the first quartile of their respective ranking systems. These ratings also reflect the impact of our anchor bottlers' cash flows and debt.

As discussed in Note 5, we are evaluating our options with respect to repatriating undistributed international earnings under the AJCA. If we decide to repatriate funds in excess of available international cash, we would be required to borrow funds. We would not expect this activity to adversely impact our credit ratings.

### Credit Facilities and Long-Term Contractual Commitments

See Note 9 for a description of our credit facilities and long-term contractual commitments.

### Off-Balance Sheet Arrangements

It is not our business practice to enter into off-balance sheet arrangements, other than in the normal course of business, nor is it our policy to issue guarantees to our bottlers, noncontrolled affiliates or third parties. However, certain guarantees were necessary to

facilitate the separation of our bottling and restaurant operations from us. As of year-end 2004, we believe it is remote that these guarantees would require any cash payment. See Note 9 for a description of our off-balance sheet arrangements.

### Financial Position

Significant changes in our consolidated balance sheet from December 27, 2003 to December 25, 2004 not discussed above were as follows:

- Investments in noncontrolled affiliates increased \$364 million primarily due to higher equity income, partially offset by dividends received.
- Income taxes payable decreased \$512 million primarily reflecting net tax payments of \$1.8 billion, partially offset by our current provision. The payments include \$760 million paid in the second quarter as a result of our 2003 settlement with the IRS.

## Future Outlook

Our long-term financial targets are mid single-digit volume and net revenue growth, and low double-digit EPS growth. The results of any one year may differ from our long-term targets. Our 2005 results will include the results of a 53rd week.

# Consolidated Statement of Income

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

(in millions except per share amounts)	2004	2003	2002
<b>Net Revenue</b> .....	<b>\$29,261</b>	<b>\$26,971</b>	<b>\$25,112</b>
Cost of sales.....	13,406	12,379	11,497
Selling, general and administrative expenses.....	10,299	9,460	8,958
Amortization of intangible assets.....	147	145	138
Impairment and restructuring charges.....	150	147	—
Merger-related costs.....	—	59	224
<b>Operating Profit</b> .....	<b>5,259</b>	<b>4,781</b>	<b>4,295</b>
Bottling equity income.....	380	323	280
Interest expense.....	(167)	(163)	(178)
Interest income.....	74	51	36
<b>Income from Continuing Operations before Income Taxes</b> .....	<b>5,546</b>	<b>4,992</b>	<b>4,433</b>
<b>Provision for Income Taxes</b> .....	<b>1,372</b>	<b>1,424</b>	<b>1,433</b>
<b>Income from Continuing Operations</b> .....	<b>4,174</b>	<b>3,568</b>	<b>3,000</b>
<b>Tax Benefit from Discontinued Operations</b> .....	<b>38</b>	<b>—</b>	<b>—</b>
<b>Net Income</b> .....	<b>\$ 4,212</b>	<b>\$ 3,568</b>	<b>\$ 3,000</b>
<b>Net Income per Common Share — Basic</b>			
Continuing operations.....	\$2.45	\$2.07	\$1.69
Discontinued operations.....	0.02	—	—
<b>Total</b> .....	<b>\$2.47</b>	<b>\$2.07</b>	<b>\$1.69</b>
<b>Net Income per Common Share — Diluted</b>			
Continuing operations.....	\$2.41	\$2.05	\$1.68
Discontinued operations.....	0.02	—	—
<b>Total</b> .....	<b>\$2.44*</b>	<b>\$2.05</b>	<b>\$1.68</b>

\*Based on unrounded amounts.

See accompanying notes to consolidated financial statements.

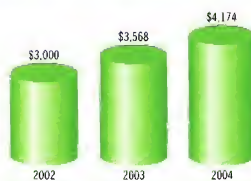
**Net Revenue**



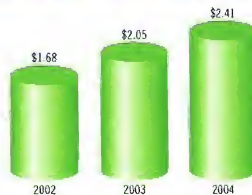
**Operating Profit**



**Income from Continuing Operations**



**Net Income per Common Share — Continuing Operations**



# Consolidated Statement of Cash Flows

PepsiCo, Inc. and Subsidiaries  
Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

(in millions)	2004	2003	2002
<b>Operating Activities</b>			
Net income	\$ 4,212	\$ 3,568	\$ 3,000
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	1,264	1,221	1,112
Stock-based compensation expense	368	407	435
Merger-related costs	—	59	224
Impairment and restructuring charges	150	147	—
Cash payments for merger-related costs and restructuring charges	(92)	(109)	(123)
Tax benefit from discontinued operations	(38)	—	—
Pension plan contributions	(458)	(535)	(820)
Bottling equity income, net of dividends	(297)	(276)	(222)
Deferred income taxes	17	(323)	174
Other non-cash charges and credits, net	341	415	263
Changes in operating working capital, excluding effects of acquisitions and dispositions			
Accounts and notes receivable	(130)	(220)	(260)
Inventories	(100)	(49)	(53)
Prepaid expenses and other current assets	(31)	23	(78)
Accounts payable and other current liabilities	216	(11)	426
Income taxes payable	(268)	182	270
Net change in operating working capital	(313)	(75)	305
Other	(100)	(171)	279
<b>Net Cash Provided by Operating Activities</b>	<b>5,054</b>	<b>4,328</b>	<b>4,627</b>
<b>Investing Activities</b>			
Capital spending	(1,387)	(1,345)	(1,437)
Sales of property, plant and equipment	38	49	89
Acquisitions and investments in noncontrolled affiliates	(64)	(71)	(351)
Divestitures	52	46	376
Short-term investments, by original maturity			
More than three months — purchases	(44)	(38)	(62)
More than three months — maturities	38	28	122
Three months or less, net	(963)	(940)	697
Snack Ventures Europe consolidation	—	—	39
<b>Net Cash Used for Investing Activities</b>	<b>(2,330)</b>	<b>(2,271)</b>	<b>(527)</b>
<b>Financing Activities</b>			
Proceeds from issuances of long-term debt	504	52	11
Payments of long-term debt	(512)	(641)	(353)
Short-term borrowings, by original maturity			
More than three months — proceeds	153	88	707
More than three months — payments	(160)	(115)	(809)
Three months or less, net	1,119	40	40
Cash dividends paid	(1,329)	(1,070)	(1,041)
Share repurchases — common	(3,028)	(1,929)	(2,158)
Share repurchases — preferred	(27)	(16)	(32)
Proceeds from exercises of stock options	965	689	456
<b>Net Cash Used for Financing Activities</b>	<b>(2,315)</b>	<b>(2,902)</b>	<b>(3,179)</b>
Effect of exchange rate changes on cash and cash equivalents	51	27	34
<b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>	<b>460</b>	<b>(818)</b>	<b>955</b>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>820</b>	<b>1,638</b>	<b>683</b>
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 1,280</b>	<b>\$ 820</b>	<b>\$ 1,638</b>

See accompanying notes to consolidated financial statements.



# Consolidated Balance Sheet

PepsiCo, Inc. and Subsidiaries  
December 25, 2004 and December 27, 2003

(in millions except per share amounts)

	2004	2003
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents.....	\$ 1,280	\$ 820
Short-term investments.....	2,165	1,181
	<b>3,445</b>	<b>2,001</b>
Accounts and notes receivable, net.....	2,999	2,830
Inventories.....	1,541	1,412
Prepaid expenses and other current assets.....	654	687
<b>Total Current Assets.....</b>	<b>8,639</b>	<b>6,930</b>
<b>Property, Plant and Equipment, net.....</b>	<b>8,149</b>	<b>7,828</b>
<b>Amortizable Intangible Assets, net.....</b>	<b>598</b>	<b>718</b>
Goodwill.....	3,909	3,796
Other nonamortizable intangible assets.....	933	869
<b>Nonamortizable Intangible Assets.....</b>	<b>4,842</b>	<b>4,665</b>
<b>Investments in Noncontrolled Affiliates.....</b>	<b>3,284</b>	<b>2,920</b>
<b>Other Assets.....</b>	<b>2,475</b>	<b>2,266</b>
<b>Total Assets.....</b>	<b>\$27,987</b>	<b>\$25,327</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Short-term obligations.....	\$ 1,054	\$ 591
Accounts payable and other current liabilities.....	5,599	5,213
Income taxes payable.....	99	611
<b>Total Current Liabilities.....</b>	<b>6,752</b>	<b>6,415</b>
<b>Long-Term Debt Obligations.....</b>	<b>2,397</b>	<b>1,702</b>
<b>Other Liabilities.....</b>	<b>4,099</b>	<b>4,075</b>
<b>Deferred Income Taxes.....</b>	<b>1,216</b>	<b>1,261</b>
<b>Total Liabilities.....</b>	<b>14,464</b>	<b>13,453</b>
<b>Preferred Stock, no par value.....</b>	<b>41</b>	<b>41</b>
<b>Repurchased Preferred Stock.....</b>	<b>(90)</b>	<b>(63)</b>
<b>Common Shareholders' Equity</b>		
Common stock, par value 1⅓¢ per share (issued 1,782 shares).....	30	30
Capital in excess of par value.....	618	548
Retained earnings.....	18,730	15,961
Accumulated other comprehensive loss.....	(886)	(1,267)
	<b>18,492</b>	<b>15,272</b>
Less: repurchased common stock, at cost (103 and 77 shares, respectively).....	(4,920)	(3,376)
<b>Total Common Shareholders' Equity.....</b>	<b>13,572</b>	<b>11,896</b>
<b>Total Liabilities and Shareholders' Equity.....</b>	<b>\$27,987</b>	<b>\$25,327</b>

See accompanying notes to consolidated financial statements.

# Consolidated Statement of Common Shareholders' Equity

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

(in millions)	2004		2003		2002	
	Shares	Amount	Shares	Amount	Shares	Amount
<b>Common Stock</b>	<b>1,782</b>	<b>\$ 30</b>	<b>1,782</b>	<b>\$ 30</b>	<b>1,782</b>	<b>\$ 30</b>
<b>Capital in Excess of Par Value</b>						
Balance, beginning of year		548		207		115
Stock-based compensation expense		368		407		435
Stock option exercises <sup>(a)</sup>		(298)		(66)		(339)
Other		—		—		(4)
Balance, end of year		618		548		207
<b>Retained Earnings</b>						
Balance, beginning of year		15,961		13,489		11,535
Net income <sup>(b)</sup>		4,212		3,568		3,000
Cash dividends declared — common		(1,438)		(1,082)		(1,042)
Cash dividends declared — preferred		(3)		(3)		(4)
Cash dividends declared — RSUs		(2)		—		—
Other		—		(11)		—
Balance, end of year		18,730		15,961		13,489
<b>Accumulated Other Comprehensive Loss</b>						
Balance, beginning of year		(1,267)		(1,672)		(1,646)
Currency translation adjustment <sup>(b)</sup>		401		410		56
Cash flow hedges, net of tax <sup>(b)</sup>		(7)		(12)		18
Minimum pension liability adjustment, net of tax <sup>(b)</sup>		(19)		7		(99)
Other <sup>(b)</sup>		6		—		(1)
Balance, end of year		(886)		(1,267)		(1,672)
<b>Repurchased Common Stock</b>						
Balance, beginning of year	(77)	(3,376)	(60)	(2,524)	(26)	(1,268)
Share repurchases	(58)	(2,994)	(43)	(1,946)	(53)	(2,192)
Stock option exercises	32	1,434	26	1,096	19	931
Other	—	16	—	(2)	—	5
Balance, end of year	(103)	(4,920)	(77)	(3,376)	(60)	(2,524)
<b>Total Common Shareholders' Equity</b>		<b>\$13,572</b>		<b>\$11,896</b>		<b>\$ 9,530</b>

(a) Includes total tax benefit of \$183 million in 2004, \$340 million in 2003 and \$136 million in 2002.

(b) Combined, these amounts represent total comprehensive income of \$4,593 million in 2004, \$3,973 million in 2003 and \$2,974 million in 2002. See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

## Note 1 — Basis of Presentation and Our Divisions

### Basis of Presentation

Our financial statements include the consolidated accounts of PepsiCo, Inc. and the affiliates that we control. In addition, we include our share of the results of certain other affiliates based on our economic ownership interest. We do not control these other affiliates, as our ownership in these other affiliates is generally less than 50%. Our share of the net income of noncontrolled bottling affiliates is reported in our income statement as bottling equity income. See Note 8 for additional information on our noncontrolled bottling affiliates. Our share of other noncontrolled affiliates is included in division operating profit. Intercompany balances and transactions are eliminated.

The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect

reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

Impairment and restructuring charges and merger-related costs (described in Note 3) and net tax benefits from continuing and discontinued operations (described in Note 5) affect the comparability of our consolidated results. See "Our Divisions" below and for additional unaudited information on these items, see "Items Affecting Comparability" in Management's Discussion and Analysis.

Tabular dollars are in millions, except per share amounts. All per share amounts reflect common per share amounts, assume dilution unless noted, and are based on unrounded amounts. Certain reclassifications were made to prior year amounts to conform to the 2004 presentation.

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### Our Divisions

We manufacture or use contract manufacturers, market and sell a variety of salty, sweet and grain-based snacks, carbonated and non-carbonated beverages, and foods through our North American and international business divisions. Our North American divisions include the United States and Canada. The accounting policies for the divisions are the same as those described in Note 2, except for certain allocation methodologies for stock-based compensation expense and pension and retiree medical expense as

described in the unaudited information in "Our Critical Accounting Policies."

Division results are based on how our Chairman and Chief Executive Officer manages our divisions. Division results exclude significant restructuring and impairment charges, merger-related costs and divested businesses. For additional unaudited information on our divisions, see "Our Operations" in Management's Discussion and Analysis.





# PEPSICO

Frito-Lay  
North America  
(FLNA)

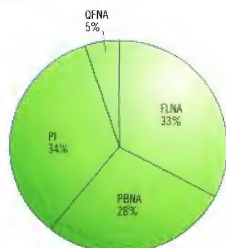
PepsiCo  
Beverages  
North America  
(PBNA)

PepsiCo  
International  
(PI)

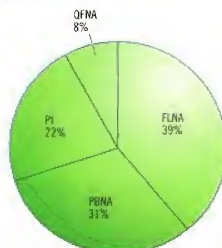
Quaker Foods  
North America  
(QFNA)

	2004	2003	2002	2004	2003	2002
		Net Revenue			Operating Profit	
FLNA .....	\$ 9,560	\$ 9,091	\$ 8,565	\$2,389	\$2,242	\$2,081
PBNA .....	8,313	7,733	7,200	1,911	1,690	1,485
PI .....	9,862	8,678	7,749	1,323	1,061	910
QFNA .....	1,526	1,467	1,464	475	470	458
Total division .....	29,261	26,969	24,978	6,098	5,463	4,934
Divested businesses .....	—	2	134	—	26	23
Corporate .....	—	—	—	(689)	(502)	(438)
	29,261	26,971	25,112	5,409	4,987	4,519
Impairment and restructuring charges .....	—	—	—	(150)	(147)	—
Merger-related costs .....	—	—	—	—	(59)	(224)
Total .....	\$29,261	\$26,971	\$25,112	\$5,259	\$4,781	\$4,295

Division Net Revenue



Division Operating Profit



## Divested Businesses

During 2003, we sold our Quaker Foods North America Mission pasta business. During 2002, we sold our Quaker Foods North America bagged cereal business and our PepsiCo International food businesses in Colombia and Venezuela. The results of these businesses are reported as divested businesses.

## Corporate

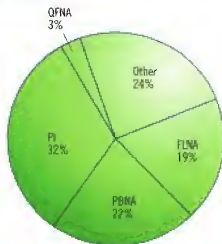
Corporate includes costs of our corporate headquarters, centrally managed initiatives, such as our BPT initiative, unallocated insurance and benefit programs, foreign exchange transaction gains and losses, profit-in-inventory elimination adjustments for our noncontrolled bottling affiliates and certain other items.

**Impairment and Restructuring Charges and Merger-Related Costs** — See Note 3.

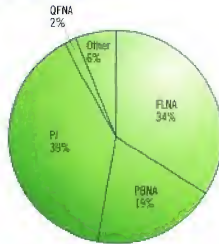
## Other Division Information

	2004	2003	2002	2004	2003	2002
	Total Assets			Capital Spending		
FLNA	\$ 5,476	\$ 5,332	\$ 5,099	\$ 469	\$ 426	\$ 523
PBNA	6,048	5,856	5,691	265	332	367
PI	8,921	8,109	7,275	537	521	473
QFNA	978	995	1,001	33	32	50
Total division	21,423	20,292	19,066	1,304	1,311	1,413
Corporate <sup>(a)</sup>	3,569	2,384	2,072	83	34	24
Investments in bottling affiliates	2,995	2,651	2,336	—	—	—
	\$27,987	\$25,327	\$23,474	\$1,387	\$1,345	\$1,437

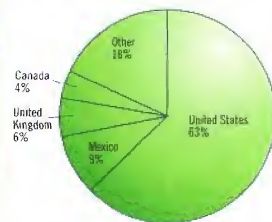
Total Assets



Capital Spending

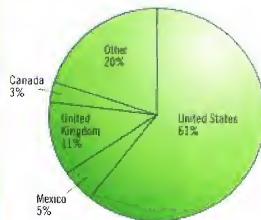


Net Revenue



	2004	2003	2002	2004	2003	2002
	Amortization of Intangible Assets			Depreciation and Other Amortization		
FLNA	\$ 3	\$ 3	\$ 3	\$ 420	\$ 416	\$ 399
PBNA	75	75	70	258	245	206
PI	68	66	64	382	350	300
QFNA	1	1	1	36	36	37
Total division	147	145	138	1,086	1,047	942
Divested businesses	—	—	—	—	—	3
Corporate	—	—	—	21	29	29
	\$147	\$145	\$138	\$1,117	\$1,076	\$974

Long-Lived Assets



	2004	2003	2002	2004	2003	2002
	Net Revenue <sup>(b)</sup>			Long-Lived Assets <sup>(c)</sup>		
U.S.	\$18,329	\$17,377	\$16,588	\$10,212	\$ 9,907	\$ 9,767
Mexico	2,724	2,642	2,686	878	869	764
United Kingdom	1,692	1,510	1,106	1,896	1,724	1,529
Canada	1,309	1,147	967	548	508	410
All other countries	5,207	4,295	3,765	3,339	3,123	2,750
	\$29,261	\$26,971	\$25,112	\$16,873	\$16,131	\$15,220

(a) Corporate assets consist principally of cash, cash equivalents and short-term investments, primarily held outside the U.S., and property, plant and equipment.

(b) Represents net revenue from businesses operating in these countries.

(c) Long-lived assets represent net property, plant and equipment, nonamortizable and net amortizable intangible assets and investments in noncontrolled affiliates. These assets are reported in the country where they are primarily used.

## Note 2 — Our Significant Accounting Policies

### Revenue Recognition

We recognize revenue upon shipment or delivery to our customers in accordance with written sales terms that do not allow for a right of return. However, our policy for direct-store-delivery (DSD) and chilled products is to remove and replace damaged and out-of-date products from store shelves to ensure that our consumers receive the product quality and freshness that they expect. Similarly, our policy for warehouse distributed products is to replace damaged and out-of-date products. Based on our historical experience with this practice, we have reserved for anticipated damaged and out-of-date products. For additional unaudited information on our revenue recognition and related policies, including our policy on bad debts, see "Our Critical Accounting Policies" in Management's Discussion and Analysis. We are exposed to concentration of credit risk by our customers, Wal-Mart and PBG. Wal-Mart represents approximately 11% of our net revenue and PBG represents approximately 10%. We have not experienced credit issues with these customers.

### Sales Incentives and Other Marketplace Spending

We offer sales incentives through various programs to our customers and consumers. Sales incentives are accounted for as a reduction of revenue and totaled \$6.6 billion in 2004, \$6.0 billion in 2003 and \$5.5 billion in 2002. Most of these incentive arrangements have terms of no more than one year. However, we have arrangements, such as fountain pouring rights, which may extend up to 15 years. Costs incurred to obtain these arrangements are expensed over the contract period and the remaining balance of \$337 million at December 25, 2004 and \$359 million at December 27, 2003 is included in other assets in our Consolidated Balance Sheet. For additional unaudited information on our sales incentives, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

Other marketplace spending includes the costs of advertising and other marketing activities and is reported as selling, general and administrative expenses. Advertising expenses were \$1.7 billion in 2004, \$1.6 billion in 2003 and \$1.5 billion in 2002. Deferred advertising costs are not expensed until the year first used and consist of:

- media and personal service prepayments,
- promotional materials in inventory, and
- production costs of future media advertising.

Deferred advertising costs of \$137 million at year-end 2004 and 2003 are classified as prepaid expenses in the Consolidated Balance Sheet.

### Distribution Costs

Distribution costs, including the costs of shipping and handling activities, are reported as selling, general and administrative expenses for DSD distribution systems. For our other distribution systems, these costs are reported in cost of sales. Shipping and handling expenses classified as selling, general and administrative expenses were \$3.3 billion in 2004, \$3.0 billion in 2003 and \$2.8 billion in 2002.

### Cash Equivalents

Cash equivalents are investments with original maturities of three months or less.

### Commitments and Contingencies

We are subject to various claims and contingencies related to lawsuits, taxes and environmental matters, as well as commitments under contractual and other commercial obligations. We recognize liabilities for contingencies and commitments when a loss is probable and estimable. For additional information on our commitments, see Note 9.

### Other Significant Accounting Policies

Our other significant accounting policies are disclosed as follows:

- *Property, Plant and Equipment and Intangible Assets* — Note 4 and, for additional unaudited information on brands and goodwill, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- *Income Taxes* — Note 5 and, for additional unaudited information, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- *Stock-Based Compensation Expense* — Note 6 and, for additional unaudited information, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- *Pension, Retiree Medical and Savings Plans* — Note 7 and, for additional unaudited information, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- *Risk Management* — Note 10 and, for additional unaudited information, see "Our Business Risks" in Management's Discussion and Analysis.



## Note 3 — Impairment and Restructuring Charges and Merger-Related Costs

### Impairment and Restructuring Charges

In the fourth quarter of 2004, we incurred a charge of \$150 million (\$96 million after-tax or \$0.06 per share) in conjunction with the consolidation of FLNA's manufacturing network as part of its ongoing productivity program. Of this charge, \$93 million relates to asset impairment, primarily reflecting the closure of four U.S. plants. Production from these plants has been redeployed to other FLNA facilities in the U.S. The remaining \$57 million includes employee-related costs of \$29 million, contract termination costs of \$8 million and other exit costs of \$20 million. Employee-related costs primarily reflect the termination costs for approximately 700 employees. As of December 25, 2004, substantially all terminations have occurred. Through December 25, 2004, we have paid \$27 million, incurred non-cash charges of \$8 million, leaving a remaining accrual of \$22 million. This accrual is included in other current liabilities and payments are expected through mid-year 2006.

In the fourth quarter of 2003, we incurred a charge of \$147 million (\$100 million after-tax or \$0.06 per share) in conjunction with actions taken to streamline our North American divisions and PepsiCo International. These actions were taken to increase focus and eliminate redundancies at PBNA and PI, and to improve the efficiency of the supply

chain at FLNA. Of this charge, \$81 million related to asset impairment, reflecting \$57 million for the closure of a snack plant in Kentucky, the retirement of snack manufacturing lines in Maryland and Arkansas and \$24 million for the closure of a PBNA office building in Florida. The remaining \$66 million included employee-related costs of \$54 million and facility and other exit costs of \$12 million. Employee-related costs primarily reflect the termination costs for approximately 850 sales, distribution, manufacturing, research and marketing employees. As of December 25, 2004, all terminations have occurred and substantially no accrual remains.

### Merger-Related Costs

In connection with the Quaker merger in 2001, we recognized merger-related costs of \$59 million (\$42 million after-tax or \$0.02 per share) and \$224 million (\$190 million after-tax or \$0.11 per share) in 2003 and 2002, respectively. At December 25, 2004, we had related accruals of \$34 million (primarily employee-related) which are included within other current liabilities in the Consolidated Balance Sheet.

## Note 4 — Property, Plant and Equipment and Intangible Assets

	Useful Life	2004	2003	2002
Property, plant and equipment, net				
Land and improvements	10 – 30 yrs.	\$ 646	\$ 591	
Buildings and improvements	20 – 44	3,605	3,415	
Machinery and equipment, including fleet	5 – 15	10,950	10,170	
Construction in progress		729	579	
		15,930	14,755	
Accumulated depreciation		(7,781)	(6,927)	
		\$ 8,149	\$ 7,828	
Depreciation expense		\$1,062	\$1,020	\$929
Amortizable intangible assets, net				
Brands	5 – 40	\$1,008	\$ 985	
Other identifiable intangibles	3 – 15	225	212	
		1,233	1,197	
Accumulated amortization		(635)	(479)	
		\$ 598	\$ 718	
Amortization expense		\$147	\$145	\$138

Depreciation and amortization are recognized on a straight-line basis over an asset's estimated useful life. Land is not depreciated and construction in

progress is not depreciated until ready for service. Amortization of intangible assets for each of the next five years, based on 2004 foreign exchange rates,

is expected to be \$141 million in 2005, \$140 million in 2006, \$24 million in 2007, \$23 million in 2008 and \$22 million in 2009.

Depreciable and amortizable assets are only evaluated for impairment upon a significant change in the operating or macroeconomic environment. In these circumstances, if an evaluation of the undiscounted cash flows indicates impairment, the asset is written down to its estimated fair value, which is generally based on discounted future cash flows. Useful lives are periodically evaluated to determine whether events or circumstances have occurred which indicate the need for revision. For additional unaudited information on our amortizable brand policies, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

## Nonamortizable Intangible Assets

Perpetual brands and goodwill are assessed for impairment at least annually to ensure that discounted future cash flows continue to exceed the related book value. A perpetual brand is impaired if its book value exceeds its fair value. Goodwill is evaluated for impairment if the book value of its reporting unit exceeds its fair value. A reporting unit can be a division or business within a division. If the fair value of an evaluated asset is less than its book value, the asset is written down based on its discounted future cash flows to fair value. No impairment charges resulted from the required impairment evaluations. The change in the book value of nonamortizable intangible assets during 2004 is as follows:

	Balance, Beginning of Year	Acquisitions	Translation and Other	Balance, End of Year
<b>Frito-Lay North America</b>				
Goodwill.....	\$ 130	\$ —	\$ 8	\$ 138
<b>PepsiCo Beverages North America</b>				
Goodwill.....	2,157	—	4	2,161
Brands .....	59	—	—	59
	2,216	—	4	2,220
<b>PepsiCo International</b>				
Goodwill.....	1,334	29	72	1,435
Brands .....	808	—	61	869
	2,142	29	133	2,304
<b>Quaker Foods North America</b>				
Goodwill.....	175	—	—	175
<b>Corporate</b>				
Pension intangible.....	2	—	3	5
Total goodwill.....	3,796	29	84	3,909
Total brands.....	867	—	61	928
Total pension intangible.....	2	—	3	5
	\$4,665	\$29	\$148	\$4,842

## Note 5 — Income Taxes

	2004	2003	2002
<b>Income before income taxes — continuing operations</b>			
U.S. ....	\$2,946	\$3,267	\$3,178
Foreign ....	2,600	1,725	1,255
	<b>\$5,546</b>	<b>\$4,992</b>	<b>\$4,433</b>
<b>Provision for income taxes — continuing operations</b>			
Current: U.S. Federal .....	\$1,030	\$1,326	\$ 948
Foreign .....	256	341	256
State .....	69	80	55
	<b>1,355</b>	<b>1,747</b>	<b>1,259</b>
Deferred: U.S. Federal .....	11	(274)	146
Foreign .....	5	(47)	11
State .....	1	(2)	17
	<b>17</b>	<b>(323)</b>	<b>174</b>
	<b>\$1,372</b>	<b>\$1,424</b>	<b>\$1,433</b>
<b>Tax rate reconciliation — continuing operations</b>			
U.S. Federal statutory tax rate .....	35.0%	35.0%	35.0%
State income tax, net of U.S. Federal tax benefit .....	0.8	1.0	1.0
Lower taxes on foreign results .....	(5.4)	(5.5)	(3.5)
Settlement of prior years audit .....	(4.8)	(2.2)	—
Merger-related costs and impairment and restructuring charges .....	—	0.1	1.0
Other, net .....	(0.9)	0.1	(1.2)
Annual tax rate .....	<b>24.7%</b>	<b>28.5%</b>	<b>32.3%</b>
<b>Deferred tax liabilities</b>			
Investments in noncontrolled affiliates .....	\$ 850	\$ 792	
Property, plant and equipment .....	857	806	
Pension benefits .....	669	563	
Intangible assets other than nondeductible goodwill .....	153	146	
Safe harbor leases .....	13	33	
Zero coupon notes .....	46	53	
Other .....	144	199	
Gross deferred tax liabilities .....	<b>2,732</b>	<b>2,592</b>	
<b>Deferred tax assets</b>			
Net carryforwards .....	666	535	
Stock-based compensation .....	402	332	
Retiree medical benefits .....	402	343	
Other employee-related benefits .....	379	384	
Various current and noncurrent liabilities .....	460	482	
Gross deferred tax assets .....	<b>2,309</b>	<b>2,076</b>	
Valuation allowances .....	(564)	(438)	
Deferred tax assets, net .....	<b>1,745</b>	<b>1,638</b>	
Net deferred tax liabilities .....	<b>\$ 987</b>	<b>\$ 954</b>	
<b>Deferred taxes included within:</b>			
Prepaid expenses and other current assets .....	\$229	\$307	
Deferred income taxes .....	<b>\$1,216</b>	<b>\$1,261</b>	
<b>Analysis of valuation allowances</b>			
Balance, beginning of year .....	\$438	\$487	\$511
Provision/(benefit) .....	118	(52)	(22)
Other additions/(deductions) .....	8	3	(2)
Balance, end of year .....	<b>\$564</b>	<b>\$438</b>	<b>\$487</b>



For additional unaudited information on our income tax policies, including our reserves for income taxes, see “Our Critical Accounting Policies” in Management’s Discussion and Analysis.

#### **Carryforwards, Credits and Allowances**

Operating loss carryforwards totaling \$4.3 billion at year-end 2004 are being carried forward in a number of foreign and state jurisdictions where we are permitted to use tax operating losses from prior periods to reduce future taxable income. These operating losses will expire as follows: \$0.1 billion in 2005, \$3.1 billion between 2006 and 2024 and \$1.1 billion may be carried forward indefinitely. In addition, certain tax credits generated in prior periods of approximately \$49.3 million are available to reduce certain foreign tax liabilities through 2011. We establish valuation allowances for our deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit.

#### **Tax Benefit from Discontinued Operations**

In the fourth quarter of 2004, we reached agreement with the taxing authorities for an open issue related to our discontinued restaurant operations which resulted in a tax benefit of \$38 million or \$0.02 per share.

#### **Undistributed International Earnings**

At December 25, 2004, we had approximately \$11.9 billion of undistributed international earnings. We have not recognized any U.S. tax expense on these earnings, since we intend to reinvest the earnings outside the U.S. for the foreseeable future, subject to the opportunity afforded us as a result of the American Jobs Creation Act of 2004 (AJCA), which was signed by the President on October 22, 2004. The AJCA creates a temporary incentive for U.S. corporations to repatriate undistributed international earnings by providing an 85% dividends received deduction. The deduction is subject to a number of limitations and uncertainty remains as to how to interpret certain provisions in the AJCA. Therefore, we have not decided on whether, or to what extent, we might repatriate undistributed foreign earnings to the U.S. Until further guidance is available from the Treasury Department, or possibly from Congress, it is difficult to fully quantify the impact of the AJCA if we were to take advantage of that legislation. Based on our analysis to date, however, the maximum amount that we can repatriate under the AJCA is \$7.5 billion, which would result in a tax liability of approximately \$475 million based on our expectation of how the AJCA will be interpreted. We expect to finalize our assessment of the opportunity presented by the AJCA as soon as further guidance is available, which could be as early as the first or second quarter of 2005.

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## **Note 6 — Stock-Based Compensation**

Our stock-based compensation program is a broad-based program designed to attract and retain employees while also aligning employees’ interests with the interests of our shareholders. Employees at all levels participate in our stock-based compensation program. In addition, members of our Board of Directors participate in our stock-based compensation program in connection with their service on our Board. Stock options and restricted stock units (RSUs) are granted to employees under the 2003 Long-Term Incentive Plan (LTIP), our only active stock-based plan. At year-end 2004, 62 million shares were available for future executive and SharePower grants. For additional unaudited information on our stock-based compensation program, see “Our Critical Accounting Policies” in Management’s Discussion and Analysis.

#### **SharePower Grants**

SharePower options are awarded under our 2003 LTIP to all eligible employees, based on job level or classification, and in the case of international employees, tenure as well. Options become exercisable after three years and have a 10-year term. In 2004, SharePower grants represented approximately 38% of our annual employee option grants.

#### **Executive Grants**

All senior management and certain middle management are eligible for LTIP grants. All stock option grants have an exercise price equal to the fair market value of our common stock on the day of grant and generally have a 10-year term with vesting after three years. There have been no reductions to the exercise price of previously issued awards, and any repricing of awards would require approval of our shareholders.

Beginning in 2004, executives who are awarded long-term incentives based on their performance are offered the choice of stock options or RSUs. RSUs also generally vest after three years of service and each restricted stock unit can be settled in a share of our stock after the vesting period. Senior officers do not have a choice and are granted 50% stock options and 50% RSUs. Executives who elect RSUs receive one RSU for every four stock options that would have otherwise been granted. Vesting of RSU awards for senior officers is contingent upon the achievement of pre-established performance targets. In 2004, we granted three million RSUs with a weighted-average fair value of \$47.28.

### Method of Accounting and Our Assumptions

We account for our employee stock options under the fair value method of accounting using a Black-Scholes model to measure stock-based compensation expense at the date of grant. Two of our anchor bottlers, PBG and PAS, will be adopting SFAS 123R in 2005. They are currently evaluating the impact of SFAS 123R on their respective financial statements, which will impact our bottling equity income.

Our weighted-average Black-Scholes fair value assumptions include:

	2004	2003	2002
Expected life	6 yrs.	6 yrs.	6 yrs.
Risk free interest rate	3.3%	3.1%	4.4%
Expected volatility	26%	27%	27%
Expected dividend yield	1.8%	1.15%	1.14%

### Our Stock Option Activity<sup>(a)</sup>

	2004		2003		2002	
	Options	Average Price <sup>(b)</sup>	Options	Average Price <sup>(b)</sup>	Options	Average Price <sup>(b)</sup>
Outstanding at beginning of year	198,173	\$38.12	190,432	\$36.45	176,922	\$32.35
Granted	14,137	47.47	41,630	39.89	37,376	48.75
Exercised	(31,614)	30.57	(25,833)	26.74	(19,558)	23.32
Forfeited/expired	(6,435)	43.82	(8,056)	43.56	(4,308)	39.01
Outstanding at end of year	174,261	40.05	198,173	38.12	190,432	36.45
Exercisable at end of year	94,643	\$36.41	97,663	\$32.56	82,620	\$30.14
Weighted average fair value of options granted		\$12.04		\$11.21		\$15.20

### Stock options outstanding and exercisable at December 25, 2004<sup>(a)</sup>

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Options	Average Life <sup>(c)</sup>	Average Price <sup>(b)</sup>	Options	Average Price <sup>(b)</sup>
\$14.40 to \$21.54	4,209	1.75 yrs.	\$20.69	4,209	\$20.69
\$23.00 to \$33.75	24,291	3.49	29.97	24,129	29.98
\$34.00 to \$43.50	98,348	6.17	39.34	59,580	38.97
\$43.75 to \$54.25	47,413	7.76	48.56	6,725	47.44
	174,261	6.04	40.05	94,643	36.41

(a) Options are in thousands and include options previously granted under Quaker plans. No additional options or shares may be granted under the Quaker plans.

(b) Weighted-average exercise price.

(c) Weighted-average contractual life remaining in years.

## Note 7 — Pension, Retiree Medical and Savings Plans

Our pension plans cover full-time employees in the U.S. and certain international employees. Benefits are determined based on either years of service or a combination of years of service and earnings. U.S. retirees are also eligible for medical and life insurance benefits (retiree medical) if they meet age and service requirements. Generally, our share of retiree medical costs is capped at specified dollar amounts, which vary based upon years of service, with retirees contributing the remainder up to the total cost. We use a September 30 measurement date and all plan assets and liabilities are reported as of that date. The cost or benefit of plan changes which increase or decrease benefits for prior employee service (prior service cost) is included in expense on a straight-line basis over the average remaining service period of employees expected to receive benefits.

The Medicare Act was signed into law in December 2003 and we applied the provisions of the Medicare Act to our plans in 2004. The Medicare Act provides a subsidy for sponsors of retiree medical plans who offer drug benefits equivalent to those provided under Medicare. Our 2004 retiree medical costs were \$7 million lower as a result of the Medicare Act and our 2004 liability was reduced by \$80 million. We expect our 2005 retiree medical costs to be approximately \$10 million lower as a result of the Medicare Act. Further guidance on the Medicare Act is pending which could impact our previously recognized amounts.

For additional unaudited information on our pension and retiree medical plans and related accounting policies and assumptions, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

	2004	2003	2002
<b>Weighted average pension assumptions</b>			
Liability discount rate	6.1%	6.1%	6.7%
Expense discount rate	6.1%	6.7%	7.4%
Expected return on plan assets	7.8%	8.2%	9.1%
Rate of salary increases	4.4%	4.4%	4.4%

#### Components of pension expense

Service cost	\$ 220	\$ 178	\$ 156
Interest cost	318	284	265
Expected return on plan assets	(390)	(359)	(329)
Amortization of prior service cost	7	6	6
Amortization of experience loss	90	48	4
Pension expense	245	157	102
Settlement/curtailment loss	5	—	—
Special termination benefits	20	4	9
Total	\$ 270	\$ 161	\$ 111

#### Weighted average retiree medical assumptions

Liability discount rate	6.1%	6.1%	6.7%
Expense discount rate	6.1%	6.7%	7.5%

#### Components of retiree medical expense

Service cost	\$ 38	\$ 33	\$ 25
Interest cost	72	73	66
Amortization of prior service benefit	(8)	(3)	(7)
Amortization of experience loss	19	13	3
Retiree medical expense	121	116	87
Special termination benefits	4	—	1
Total	\$ 125	\$ 116	\$ 88

	2004	2003	2004	2003
	Pension		Retiree Medical	

#### Change in projected benefit liability

Liability at beginning of year	\$5,214	\$4,324	\$1,264	\$1,120
Service cost	220	178	38	33
Interest cost	318	284	72	73
Plan amendments	(16)	5	(41)	(63)
Participant contributions	9	6	—	—
Experience loss	334	541	58	171
Benefit payments	(234)	(208)	(76)	(70)
Settlement/curtailment loss	(11)	—	—	—
Special termination benefits	19	4	4	—
Foreign currency adjustment	67	80	—	—
Liability at end of year	\$5,920	\$5,214	\$1,319	\$1,264
Liability at end of year for service to date	\$4,943	\$4,350		

	2004	2003	2004	2003
	Pension		Retiree Medical	
<b>Change in fair value of plan assets</b>				
Fair value at beginning of year	\$4,245	\$3,537	\$ —	\$ —
Actual return on plan assets	469	281	—	—
Employer contributions/funding	453	552	76	70
Participant contributions	9	6	—	—
Benefit payments	(234)	(208)	(76)	(70)
Settlement/curtailment loss	(11)	—	—	—
Foreign currency adjustment	59	77	—	—
Fair value at end of year	\$4,990	\$4,245	\$ —	\$ —

#### Funded status as recognized in the Consolidated Balance Sheet

Funded status at end of year	\$ (930)	\$ (969)	\$(1,319)	\$(1,264)
Unrecognized prior service cost/(benefit)	22	44	(116)	(83)
Unrecognized experience loss	2,393	2,207	473	434
Fourth quarter benefit payments	12	6	19	19
Net amounts recognized	\$1,497	\$1,288	\$(943)	\$(894)

#### Net amounts as recognized in the Consolidated Balance Sheet

Other assets	\$1,866	\$1,581	\$ —	\$ —
Intangible assets	5	2	—	—
Other liabilities	(424)	(334)	(943)	(894)
Accumulated other comprehensive loss	50	39	—	—
Net amounts recognized	\$1,497	\$1,288	\$(943)	\$(894)

#### Components of increase in unrecognized experience loss

Decrease in discount rate	\$ 4	\$446	\$ —	\$ 60
Employee-related assumption changes	261	(6)	109	80
Liability-related experience different from assumptions	69	100	31	32
Actual asset return different from expected return	(79)	78	—	—
Amortization of losses	(90)	(48)	(19)	(13)
Other, including foreign currency adjustments and 2003 Medicare Act	21	30	(82)	—
Total	\$186	\$600	\$39	\$159

#### Selected information for plans with liability for service to date in excess of plan assets

Liability for service to date	\$(511)	\$(383)	\$(1,319)	\$(1,264)
Projected benefit liability	\$(912)	\$(727)	\$(1,319)	\$(1,264)
Fair value of plan assets	\$ 172	\$123	—	—



Of the total projected pension benefit liability at year-end 2004, \$637 million relates to plans that we do not fund because of unfavorable tax treatment.

### Future Benefit Payments

Our estimated future benefit payments to beneficiaries are as follows:

	2005	2006	2007	2008	2009	2010-14
Pension	\$215	\$220	\$235	\$255	\$280	\$1,855
Retiree medical	\$85	\$80	\$85	\$90	\$95	\$515

These benefit payments to beneficiaries include payments made from both funded and unfunded pension plans. The above payments exclude any discretionary contributions we may make. We expect such contributions to be approximately \$400 million in 2005.

### Pension Assets

The expected return on pension plan assets is based on our historical experience, our pension plan investment guidelines, and our expectations for long-term rates of return. Our pension plan investment guidelines are established based upon an evaluation of market conditions, tolerance for risk and cash requirements for benefit payments. Our target allocation for 2005 and actual pension plan asset allocation are as follows:

Asset Category	Target Allocation		Actual Allocation	
	2005	2004	2003	
Equity securities	60%	60%	57%	
Debt securities	40%	39%	34%	
Other, primarily cash	—	1%	9%	
Total	100%	100%	100%	

Pension assets include approximately 5.5 million shares of PepsiCo common stock with a market value of \$267 million in 2004, and 5.5 million shares with a market value of \$251 million in 2003. Our investment policy limits the investment in PepsiCo stock at the time of investment to 10% of the fair value of plan assets.

### Retiree Medical Cost Trend Rates

An average increase of 11% in the cost of covered retiree medical benefits is assumed for 2005. This average increase is then projected to decline gradually to 5% in 2010 and thereafter. These assumed health care cost trend rates have an impact on the retiree medical plan expense and liability. However, the cap on our share of retiree medical costs limits the impact. A 1 percentage point change in the assumed health care trend rate would have the following effects:

	1% Increase	1% Decrease
2004 service and interest cost components	\$4	\$(3)
2004 benefit liability	\$46	\$(41)

### Savings Plan

Our U.S. employees are eligible to participate in 401(k) savings plans, which are voluntary defined contribution plans. The plans are designed to provide employees with retirement savings and strengthen their incentive to build shareholder value. We make matching contributions on a portion of eligible pay based on years of service. In 2004, our contribution was \$35 million.

## Note 8 — Noncontrolled Bottling Affiliates

Our most significant noncontrolled bottling affiliates are The Pepsi Bottling Group (PBG) and PepsiAmericas (PAS). Approximately 10% of our net revenue reflects sales to PBG.

### The Pepsi Bottling Group

In addition to approximately 42% of PBG's outstanding common stock that we own at year-end 2004, we own 100% of PBG's class B common stock and approximately 7% of the equity of Bottling Group, LLC, PBG's principal operating subsidiary. This gives us economic ownership of approximately 46% of PBG's combined operations. PBG's summarized financial information is as follows:

	2004	2003	2002
Current assets	\$ 2,039	\$ 3,039	
Noncurrent assets	8,754	8,505	
Total assets	\$10,793	\$11,544	
Current liabilities	\$1,581	\$2,478	
Noncurrent liabilities	6,818	6,789	
Minority interest	445	396	
Total liabilities	\$8,844	\$9,663	
Our investment	\$1,594	\$1,353	
Net revenue	\$10,906	\$10,265	\$9,216
Gross profit	\$5,250	\$5,050	\$4,215
Operating profit	\$976	\$956	\$898
Net income	\$457	\$416	\$428

In December 2002, PBG acquired Pepsi-Gemex, a franchise bottler in Mexico, in which we previously held a 34% ownership interest. The table above includes the results of Pepsi-Gemex from the transaction date forward.



Our investment in PBG, which includes the related goodwill, was \$320 million higher than our ownership interest in their net assets at year-end 2004. Based upon the quoted closing price of PBG shares at year-end 2004, the calculated market value of our shares in PBG, excluding our investment in Bottling Group, LLC, exceeded our investment balance by approximately \$1.7 billion.

### PepsiAmericas

At year-end 2004, we owned approximately 41% of PepsiAmericas and their summarized financial information is as follows:

	2004	2003	2002
Current assets	\$ 530	\$ 576	
Noncurrent assets	3,000	3,021	
Total assets	\$3,530	\$3,597	
Current liabilities	\$ 521	\$ 599	
Noncurrent liabilities	1,386	1,433	
Total liabilities	\$1,907	\$2,032	
Our investment	\$924	\$847	
Net revenue	\$3,345	\$3,237	\$3,240
Gross profit	\$1,423	\$1,360	\$1,272
Operating profit	\$340	\$316	\$301
Income from continuing operations	\$182	\$158	\$136
Net income	\$182	\$158	\$130

Our investment in PAS, which includes the related goodwill, was \$253 million higher than our ownership interest in their net assets at year-end 2004. Based upon the quoted closing price of PAS shares at year-end 2004, the calculated market value of our shares in PepsiAmericas exceeded our investment balance by approximately \$277 million.

In December 2004, PAS announced their acquisition of a regional bottler, Central Investment Corporation, for \$340 million.

### Related Party Transactions

Our significant related party transactions involve our noncontrolled bottling affiliates. We sell concentrate to these affiliates that is used in the production of carbonated soft drinks and non-carbonated beverages. We also sell certain finished goods to these affiliates and we receive royalties for the use of our trademarks for certain products. Sales of concentrate and finished goods are reported net of bottler funding. For further unaudited information on these bottlers, see "Our Customers" in Management's Discussion and Analysis. These transactions with our bottling affiliates are reflected in our consolidated financial statements as follows:

	2004	2003	2002
Net revenue	\$4,170	\$3,699	\$3,455
Selling, general and administrative expenses	\$114	\$128	\$105
Accounts and notes receivable	\$157	\$158	
Accounts payable and other current liabilities	\$95	\$138	

Such amounts are settled on terms consistent with other trade receivables and payables. See Note 9 regarding our guarantee of certain PBG debt.

In addition, we coordinate, on an aggregate basis, the negotiation and purchase of sweeteners and other raw materials requirements for certain of our bottlers with suppliers. Once we have negotiated the contracts, the bottlers order and take delivery directly from the supplier and pay the suppliers directly. Consequently, these transactions are not reflected in our consolidated financial statements. As the contracting party, we could be liable to these suppliers in the event of any nonpayment by our bottlers, but we consider this exposure to be remote.

## Note 9 — Debt Obligations and Commitments

	2004	2003
<b>Short-term debt obligations</b>		
Current maturities of long-term debt	\$ 160	\$ 446
Other borrowings (3.2% and 5.1%)	1,644	520
Amounts reclassified to long-term debt	(750)	(375)
	\$1,054	\$591
<b>Long-term debt obligations</b>		
Short-term borrowings, reclassified	\$ 750	\$ 375
Notes due 2005-2026 (4.7% and 5.7%)	1,274	1,186
Zero coupon notes, \$575 million due 2005-2012 (13.4%)	321	330
Other, due 2005-2014 (6.2% and 6.4%)	212	257
	2,557	2,148
Less: current maturities of long-term debt obligations	(160)	(446)
	\$2,397	\$1,702

The interest rates in the above table reflect weighted-average rates as of year-end.

Short-term borrowings are reclassified to long-term when we have the intent and ability, through the existence of the unused lines of credit, to refinance these borrowings on a long-term basis. At year-end 2004, we maintained \$1.5 billion in corporate lines of credit subject to normal banking terms and conditions. These credit facilities support short-term debt issuances and remained unused as of December 25, 2004. Of the \$1.5 billion, \$750 million expires in June 2005 with the remaining \$750 million expiring in June 2009. Upon consent of PepsiCo and the lenders, these facilities can be extended an additional year. In addition, \$267 million of our debt was outstanding on various lines of credit maintained for our international divisions. These lines of credit are subject to normal banking terms and conditions and are committed to the extent of our borrowings.

## Interest Rate Swaps

We entered into interest rate swaps in 2004 to effectively change the interest rate of a specific debt issuance from a fixed rate to a variable rate. The notional amount of the interest rate swaps outstanding at December 25, 2004 was \$500 million. The interest rate received was 3.2% and the weighted-average interest rate paid was 1.7%. The variable weighted-average interest rate that we pay is linked to LIBOR and is subject to change. The terms of the interest rate swaps match the terms of the debt they modify. The swaps terminate in 2007.

At December 25, 2004, approximately 67% of total debt, after the impact of the associated interest rate swaps, was

exposed to variable interest rates, compared to 43% at December 27, 2003. In addition to variable rate long-term debt, all debt with maturities of less than one year is categorized as variable for purposes of this measure.

## Cross Currency Interest Rate Swaps

In 2004, we entered into a cross currency interest rate swap to hedge the currency exposure on U.S. dollar denominated debt of \$50 million held by a foreign affiliate. The terms of this swap match the terms of the debt it modifies. The swap terminates in 2008. The unrealized loss related to this swap was \$3 million at December 25, 2004, resulting in a U.S. dollar liability of \$53 million.

## Long-Term Contractual Commitments

Payments Due by Period	Total	2005	2006-2007	2008-2009	2010 & beyond
Long-term debt obligations <sup>(a)</sup>	\$2,397	\$ —	\$ 722	\$1,262	\$ 413
Non-cancelable operating leases	666	155	193	120	198
Purchasing commitments <sup>(b)</sup>	4,386	1,225	1,243	792	1,126
Marketing commitments	1,413	440	422	262	289
Other commitments	136	104	25	6	1
	\$8,998	\$1,924	\$2,605	\$2,442	\$2,027

(a) Excludes current maturities of long-term debt of \$160 million which are classified within current liabilities.

(b) Includes approximately \$30 million of long-term commitments which are reflected in other liabilities in our Consolidated Balance Sheet.

The above table reflects non-cancelable commitments as of December 25, 2004 based on year-end foreign exchange rates.

Most long-term contractual commitments, except for our long-term debt obligations, are not recorded in our Consolidated Balance Sheet. Non-cancelable operating leases primarily represent building leases. Non-cancelable purchasing commitments are primarily for oranges and orange juices to be used for our Tropicana brand beverages. Non-cancelable marketing commitments primarily are for sports marketing and with our fountain customers. Bottler funding is not reflected in our long-term contractual commitments as it is negotiated on an annual basis. See Note 7 regarding our pension and retiree medical obligations and discussion below regarding our commitments to noncontrolled bottling affiliates and former restaurant operations.

## Off-Balance Sheet Arrangements

It is not our business practice to enter into off-balance sheet arrangements, other than in the normal course of business, nor is it our policy to issue guarantees to our bottlers, non-

controlled affiliates or third parties. However, certain guarantees were necessary to facilitate the separation of our bottling and restaurant operations from us. In connection with these transactions, we have guaranteed \$2.3 billion of Bottling Group, LLC's long-term debt through 2012 and \$39 million of YUM! Brands, Inc. (YUM) outstanding obligations, primarily property leases. The terms of our Bottling Group, LLC debt guarantee are intended to preserve the structure of PBG's separation from us and our payment obligation would be triggered if Bottling Group, LLC failed to perform under these debt obligations or the structure significantly changed. Our guarantees of certain obligations ensured YUM's continued use of certain properties. These guarantees would require our cash payment if YUM failed to perform under these lease obligations.

See "Our Liquidity, Capital Resources and Financial Position" in Management's Discussion and Analysis for further unaudited information on our borrowings.

## Note 10 — Risk Management

We are exposed to the risk of loss arising from adverse changes in:

- commodity prices, affecting the cost of our raw materials and energy;
- foreign exchange risks;
- interest rates;
- stock prices; and
- discount rates, affecting the measurement of our pension and retiree medical liabilities.

In the normal course of business, we manage these risks through a variety of strategies, including the use of derivative instruments designated as cash flow and fair value hedges.

See "Our Business Risks" in Management's Discussion and Analysis for further unaudited information on our business risks.

For cash flow hedges, changes in fair value are generally deferred in accumulated other comprehensive loss within shareholders' equity until the underlying hedged item is recognized in net income. For fair value hedges, changes in fair value are recognized immediately in earnings, consistent with the underlying hedged item. Hedging transactions are limited to an underlying exposure. As a result, any change in the value of our derivative instruments would be substantially offset by an opposite change in the value of the underlying hedged items. Hedging ineffectiveness and a net earnings

impact occur when the change in the value of the hedge does not offset the change in the value of the underlying hedged item. If the derivative instrument is terminated, we continue to defer the related gain or loss and include it as a component of the cost of the underlying hedged item. Upon determination that the underlying hedged item will not be part of an actual transaction, we recognize the related gain or loss in net income in that period. We do not use derivative instruments for trading or speculative purposes and we limit our exposure to individual counterparties to manage credit risk.

### Commodity Prices

We are subject to commodity price risk because our ability to recover increased costs through higher pricing may be limited in the competitive environment in which we operate. This risk is managed through the use of fixed-price purchase orders, pricing agreements, geographic diversity and cash flow hedges. We use cash flow hedges, with terms of no more than two years, to hedge price fluctuations related to a portion of our anticipated commodity purchases, primarily for corn, heating oil and natural gas. Any ineffectiveness is recorded immediately. However, our commodity hedges have not had any significant ineffectiveness. We classify both the earnings and cash flow impact from these hedges consistent with the underlying hedged item. During the next 12 months, we expect to reclassify gains of less than \$1 million from accumulated other comprehensive loss into net income.

### Foreign Exchange

Our operations outside of the U.S. generate over a third of our net revenue of which Mexico, the United Kingdom and Canada comprise nearly 20%. As a result, we are exposed to foreign currency risks from unforeseen economic changes and political unrest. On occasion, we enter into hedges,

primarily forward contracts with terms of no more than two years, to reduce the effect of foreign exchange rates. Ineffectiveness on these hedges has not been material.

### Interest Rates

We centrally manage our debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. We may use interest rate and cross currency interest rate swaps to manage our overall interest expense and foreign exchange risk. These instruments effectively change the interest rate and currency of specific debt issuances. These swaps are entered into concurrently with the issuance of the debt that they are intended to modify. The notional amount, interest payment and maturity date of the swaps match the principal, interest payment and maturity date of the related debt. These swaps are entered into only with strong creditworthy counterparties, are settled on a net basis and are of relatively short duration.

### Stock Prices

The portion of our deferred compensation liability that is based on certain market indices and on our stock price is subject to market risk. We hold mutual fund investments and prepaid forward contracts to manage this risk. Changes in the fair value of these investments and contracts are recognized immediately in earnings and are offset by changes in the related compensation liability.

### Fair Value

All derivative instruments are recognized in our Consolidated Balance Sheet at fair value. The fair value of our derivative instruments is generally based on quoted market prices. Book and fair values of our derivative and financial instruments are as follows:

	2004		2003	
	Book Value	Fair Value	Book Value	Fair Value
<b>Assets</b>				
Cash and cash equivalents <sup>(a)</sup>	\$1,280	\$1,280	\$820	\$820
Short-term investments <sup>(b)</sup>	\$2,165	\$2,165	\$1,181	\$1,181
Forward exchange contracts <sup>(c)</sup>	\$8	\$8	\$3	\$3
Commodity contracts <sup>(c)</sup>	\$11	\$11	\$4	\$4
Prepaid forward contracts <sup>(c)</sup>	\$120	\$120	\$107	\$107
<b>Liabilities</b>				
Forward exchange contracts <sup>(d)</sup>	\$35	\$35	\$33	\$33
Commodity contracts <sup>(d)</sup>	\$8	\$8	—	—
Debt obligations	\$3,451	\$3,676	\$2,293	\$2,569
Interest rate swaps <sup>(d)</sup>	\$1	\$1	—	—
Cross currency interest rate swaps <sup>(e)</sup>	\$3	\$3	—	—

Included in the Consolidated Balance Sheet under the captions noted above or as indicated below.

(a) Book value approximates fair value due to the short maturity.

(b) Principally short-term time deposits and includes \$118 million at December 25, 2004 and \$103 million at December 27, 2003 of mutual fund investments used to manage a portion of market risk arising from our deferred compensation liability.

(c) Includes contracts not designated as hedges and reported within current assets and other assets.

(d) Includes contracts not designated as hedges and reported within current liabilities and other liabilities.

(e) Included within long-term debt.

This table excludes guarantees, including our guarantee of \$2.3 billion of Bottling Group, LLC's long-term debt. The guarantee had a fair value of \$46 million at December 25, 2004 and \$35 million at December 27, 2003 based on an external estimate of the cost to us of transferring the liability to an independent financial institution. See Note 9 for additional information on our guarantees.



## Note 11 — Net Income per Common Share from Continuing Operations

Basic net income per common share is net income available to common shareholders divided by the weighted average of common shares outstanding during the period. Diluted net income per common share is calculated using the weighted average of common shares outstanding adjusted to include the effect that would occur if in-the-money employee stock options were exercised and RSUs and preferred shares were converted into common shares. Options to purchase

7.0 million shares in 2004, 49.0 million shares in 2003 and 37.9 million shares in 2002 were not included in the calculation of diluted earnings per common share because these options were out-of-the-money. Out-of-the-money options had average exercise prices of \$52.88 in 2004, \$48.27 in 2003 and \$48.29 in 2002.

The computations of basic and diluted net income per common share from continuing operations are as follows:

	2004		2003		2002	
	Income	Shares <sup>(a)</sup>	Income	Shares <sup>(a)</sup>	Income	Shares <sup>(a)</sup>
Net income	\$4,174		\$3,568		\$3,000	
Preferred shares:						
Dividends	(3)		(3)		(4)	
Redemption premium	(22)		(12)		(25)	
Net income available for common shareholders	\$4,149	1,696	\$3,553	1,718	\$2,971	1,753
Basic net income per common share	\$2.45		\$2.07		\$1.69	
Net income available for common shareholders	\$4,149	1,696	\$3,553	1,718	\$2,971	1,753
Dilutive securities:						
Stock options and RSUs	—	31	—	17	—	25
ESOP convertible preferred stock	24	2	15	3	28	3
Unvested stock awards	—	—	—	1	—	1
Diluted	\$4,173	1,729	\$3,568	1,739	\$2,999	1,782
Diluted net income per common share	\$2.41		\$2.05		\$1.68	

(a) Weighted average common shares outstanding.

## Note 12 — Preferred and Common Stock

As of December 25, 2004, there were 3.6 billion shares of common stock and three million shares of convertible preferred stock authorized. The preferred stock was issued only for an employee stock ownership plan (ESOP) established by Quaker and these shares are redeemable by the ESOP participants. The preferred stock accrues dividends at an annual rate of \$5.46 per share. At year-end 2004, there were 803,953 preferred shares issued and 424,853 shares outstanding. Each share is convertible at

the option of the holder into 4.9625 shares of common stock. The preferred shares may be called by us upon written notice at \$78 per share plus accrued and unpaid dividends.

As of December 25, 2004, 0.4 million outstanding shares of preferred stock with a fair value of \$110 million and 18 million shares of common stock were held in the accounts of ESOP participants. Quaker made the final award to its ESOP plan in June 2001.

	2004		2003		2002	
	Shares	Amount	Shares	Amount	Shares	Amount
Preferred stock	0.8	\$41	0.8	\$41	0.8	\$41
Repurchased preferred stock						
Balance, beginning of year	0.3	\$63	0.2	\$48	0.1	\$15
Redemptions	0.1	27	0.1	15	0.1	33
Balance, end of year	0.4	\$90	0.3	\$63	0.2	\$48



## Note 13 — Accumulated Other Comprehensive Loss

Comprehensive income is a measure of income which includes both net income and other comprehensive income or loss. Other comprehensive loss results from items deferred on the balance sheet in shareholders' equity. Other comprehensive income was \$381 million in 2004, \$405 million in 2003, and other comprehensive loss was \$26 million in 2002. The accumulated balances for each component of other comprehensive loss were as follows:

	2004	2003	2002
Currency translation adjustment	\$(720)	\$(1,121)	\$(1,531)
Cash flow hedges, net of tax <sup>(a)</sup>	(19)	(12)	—
Minimum pension liability adjustment <sup>(b)</sup>	(154)	(135)	(142)
Other	7	1	1
<b>Accumulated other comprehensive loss</b>	<b>\$(886)</b>	<b>\$(1,267)</b>	<b>\$(1,672)</b>

(a) Includes \$6 million gain in 2004, \$8 million gain in 2003 and \$4 million loss in 2002 for our share of our equity investees' accumulated derivative activity. Deferred losses reclassified into earnings were \$10 million in 2004, no impact in 2003, and \$2 million in 2002.

(b) Net of taxes of \$77 million in 2004, \$67 million in 2003 and \$72 million in 2002. Also, includes \$121 million in 2004, \$110 million in 2003 and \$99 million in 2002 for our share of our equity investees' minimum pension liability adjustments.

## Note 14 — Supplemental Financial Information

	2004	2003	2002
<b>Accounts receivable</b>			
Trade receivables	\$2,505	\$2,309	
Other receivables	581	626	
	<b>3,086</b>	<b>2,935</b>	
Allowance, beginning of year	105	116	\$121
Charged to expense	18	32	38
Deductions <sup>(a)</sup>	(25)	(43)	(46)
Other <sup>(b)</sup>	(1)	—	3
Allowance, end of year	97	105	\$116
<b>Net receivables</b>	<b>\$2,989</b>	<b>\$2,830</b>	
<b>Inventory<sup>(c)</sup></b>			
Raw materials	\$ 665	\$ 618	
Work-in-process	156	160	
Finished goods	720	634	
	<b>\$1,541</b>	<b>\$1,412</b>	
<b>Accounts payable and other liabilities</b>			
Accounts payable	\$1,731	\$1,638	
Accrued marketplace spending	1,285	1,243	
Accrued compensation and benefits	961	851	
Dividends payable	387	274	
Insurance accruals	131	151	
Other current liabilities	1,104	1,056	
	<b>\$5,599</b>	<b>\$5,213</b>	
<b>Other liabilities</b>			
Reserves for income taxes	\$1,567	\$1,775	
Other	2,532	2,300	
	<b>\$4,099</b>	<b>\$4,075</b>	
<b>Other supplemental information</b>			
Rent expense	\$245	\$231	\$194
Interest paid	\$137	\$147	\$119
Income taxes paid, net of refunds	\$1,833	\$1,530	\$700
<b>Acquisitions<sup>(d)</sup></b>			
Fair value of assets acquired	\$ 78	\$178	\$ 626
Cash paid and debt issued	(64)	(71)	(351)
<b>Liabilities assumed</b>	<b>\$ 14</b>	<b>\$107</b>	<b>\$ 275</b>

(a) Includes accounts written off.

(b) Includes collections of previously written off accounts and currency translation effects.

(c) Inventories are valued at the lower of cost or market. Cost is determined using the average, first-in, first-out (FIFO) or last-in, first-out (LIFO) methods. Approximately 16% in 2004 and 10% in 2003 of the inventory cost was computed using the LIFO method. The differences between LIFO and FIFO methods of valuing these inventories are not material.

(d) Includes our acquisition of the Wotsits brand in the United Kingdom for \$228 million in 2002.

# Management's Responsibility for Financial Reporting

## To Our Shareholders:

At PepsiCo, our actions — the actions of all our associates — are governed by our Worldwide Code of Conduct. This code is clearly aligned with our stated values — a commitment to sustained growth, through empowered people, operating with responsibility and building trust. Both the code and our core values enable us to operate with integrity — both within the letter and the spirit of the law. Our code of conduct is reinforced consistently at all levels and in all countries. We have maintained strong governance policies and practices for many years.

The management of PepsiCo is responsible for the objectivity and integrity of our consolidated financial statements. The Audit Committee of the Board of Directors has engaged independent registered public accounting firm, KPMG LLP, to audit our consolidated financial statements and they have expressed an unqualified opinion.

We are committed to providing timely, accurate and understandable information to investors. This encompasses the following.

**Maintaining strong controls over financial reporting.** Our system of internal control is based on the control criteria framework of the Committee of Sponsoring Organizations of the Treadway Commission published in their report titled, *Internal Control — Integrated Framework*. The system is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded; that assets are safeguarded; and that accounting records are sufficiently reliable to permit the preparation of financial statements that conform in all material respects with accounting principles generally accepted in the U.S. We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the specified time periods. We monitor these internal controls through self-assessments and an ongoing program of internal audits. Our internal controls are reinforced through our Worldwide Code of Conduct, which sets forth our commitment to conduct business with integrity, and within both the letter and the spirit of the law.

**Exerting rigorous oversight of the business.** We continuously review our business results and strategies. This encompasses financial discipline in our strategic and daily business decisions. Our Executive Committee is actively involved — from understanding strategies and alternatives to reviewing key initiatives and financial performance. The intent is to ensure we remain objective in our assessments, constructively challenge our approach to potential business opportunities and issues, and monitor results and controls.

**Engaging strong and effective Corporate Governance from our Board of Directors.** We have an active, capable and diligent Board that meets the required standards for independence, and we welcome the Board's oversight as a representative of our shareholders. Our Audit Committee comprises independent directors with the financial literacy, knowledge and experience to provide appropriate oversight. We review our critical accounting policies, financial reporting and internal control matters with them and encourage their direct communication with KPMG LLP, with our General Auditor, and with our General Counsel. We have recently named a senior compliance officer to lead and coordinate our compliance policies and practices.

**Providing investors with financial results that are complete, transparent and understandable.** The consolidated financial statements and financial information included in this report are the responsibility of management. This includes preparing the financial statements in accordance with accounting principles generally accepted in the U.S., which require estimates based on management's best judgment.

**PepsiCo has a strong history of doing what's right.** We realize that great companies are built on trust, strong ethical standards and principles. Our financial results are delivered from that culture of accountability, and we take responsibility for the quality and accuracy of our financial reporting.



Peter A. Bridgman  
Senior Vice President and Controllor



Indra K. Nooyi  
President and Chief Financial Officer



Steven S. Reinemund  
Chairman of the Board and Chief Executive Officer

# Management's Report on Internal Control over Financial Reporting

To Our Shareholders:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, our management concluded that our internal control over financial reporting is effective as of December 25, 2004.

KPMG LLP, an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report and, as part of their audit, has issued their report, included herein, (1) on our management's assessment of the effectiveness of our internal controls over financial reporting and (2) on the effectiveness of our internal control over financial reporting.



Peter A. Bridgman  
Senior Vice President and Controller



Indra K. Nooyi  
President and Chief Financial Officer



Steven S. Reinmund  
Chairman of the Board and Chief Executive Officer

# Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
PepsiCo, Inc.:

We have audited the accompanying Consolidated Balance Sheet of PepsiCo, Inc. and Subsidiaries as of December 25, 2004 and December 27, 2003 and the related Consolidated Statements of Income, Cash Flows and Common Shareholders' Equity for each of the years in the three-year period ended December 25, 2004. We have also audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that PepsiCo, Inc. and Subsidiaries maintained effective internal control over financial reporting as of December 25, 2004, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). PepsiCo, Inc.'s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements, an opinion on management's assessment, and an opinion on the effectiveness of PepsiCo, Inc.'s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those

policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PepsiCo, Inc. and Subsidiaries as of December 25, 2004 and December 27, 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 25, 2004, in conformity with United States generally accepted accounting principles. Also, in our opinion, management's assessment that PepsiCo, Inc. maintained effective internal control over financial reporting as of December 25, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control — Integrated Framework issued by COSO. Furthermore, in our opinion, PepsiCo, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 25, 2004, based on criteria established in Internal Control — Integrated Framework issued by COSO.

**KPMG LLP**

KPMG LLP  
New York, New York  
February 24, 2005



## Selected Financial Data (in millions except per share amounts, unaudited)

Quarterly	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenue				
2004	\$6,131	\$7,070	\$7,257	\$8,803
2003	\$5,530	\$6,538	\$6,830	\$8,073
Gross profit				
2004	\$3,320	\$3,857	\$3,957	\$4,721
2003	\$2,996	\$3,546	\$3,714	\$4,336
Impairment and restructuring charges <sup>(a)</sup>				
2004	—	—	—	\$150
2003	—	—	—	\$147
Merger-related costs <sup>(b)</sup>				
2003	\$11	\$11	\$9	\$28
Net income — continuing operations				
2004	\$804	\$1,059	\$1,364	\$947
2003	\$698	\$944	\$1,012	\$914
Tax benefit from discontinued operations <sup>(c)</sup>				
2004	—	—	—	\$38
Net income per common share — basic, continuing operations				
2004	\$0.47	\$0.62	\$0.80	\$0.56
2003	\$0.40	\$0.55	\$0.59	\$0.53
Net income per common share — diluted, continuing operations				
2004	\$0.46	\$0.61	\$0.79	\$0.55
2003	\$0.40	\$0.54	\$0.58	\$0.52
Cash dividends declared per common share				
2004	\$0.16	\$0.23	\$0.23	\$0.23
2003	\$0.15	\$0.16	\$0.16	\$0.16
2004 stock price per share <sup>(d)</sup>				
High	\$53.00	\$55.48	\$55.71	\$53.00
Low	\$45.30	\$50.28	\$48.41	\$47.37
Close	\$50.93	\$54.95	\$50.84	\$51.94
2003 stock price per share <sup>(d)</sup>				
High	\$44.06	\$45.11	\$47.98	\$48.88
Low	\$36.24	\$38.06	\$43.10	\$44.11
Close	\$41.50	\$44.74	\$44.33	\$46.47

The first, second, and third quarters consist of 12 weeks and the fourth quarter consists of 16 weeks.

(a) Impairment and restructuring charges were \$150 million (\$96 million or \$0.06 per share after-tax) in 2004 and \$147 million (\$100 million or \$0.06 after-tax) in 2003 (see Note 3).

(b) Merger-related costs (see Note 3).

2003	1Q	2Q	3Q	4Q
Pre-tax	\$11	\$11	\$9	\$28
After-tax	\$10	\$9	\$6	\$17
Per share	—	—	—	\$0.01

(c) Fourth quarter 2004 net income was \$985 million or \$0.58 per share, reflecting a tax benefit from discontinued operations of \$38 million or \$0.02 per share. See Note 5.

(d) Represents the composite high and low sales price and quarterly closing prices for one share of PepsiCo common stock.

Five-Year Summary	2004	2003	2002
Net revenue	\$29,261	\$26,971	\$25,112
Income from continuing operations	\$4,174	\$3,568	\$3,000
Net income	\$4,212	\$3,568	\$3,000
Income per common share — basic, continuing operations	\$2.45	\$2.07	\$1.69
Income per common share — diluted, continuing operations	\$2.41	\$2.05	\$1.68
Cash dividends declared per common share	\$0.850	\$0.630	\$0.595
Total assets	\$27,987	\$25,327	\$23,474
Long-term debt	\$2,397	\$1,702	\$2,187

Five-Year Summary (cont.)	2001	2000
Net revenue	\$23,512	\$22,337
Net income	\$2,400	\$2,543
Income per common share — basic	\$1.35	\$1.45
Income per common share — diluted	\$1.33	\$1.42
Cash dividends declared per common share	\$0.575	\$0.555
Total assets	\$21,695	\$20,757
Long-term debt	\$2,651	\$3,009

\* As a result of the adoption of SFAS 142 and the consolidation of SVE in 2002, the data provided above is not comparable.

\* Includes restructuring and impairment charges of:

	2004	2003	2001	2000
Pre-tax	\$150	\$147	\$31	\$184
After-tax	\$96	\$100	\$19	\$111
Per share	\$0.06	\$0.06	\$0.01	\$0.06

\* In 2003, we voluntarily adopted the fair value method of accounting for stock options. We selected the retroactive restatement method as described in SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, to adopt this accounting. Under this method, we restated our 2003, 2002 and 2001 results to recognize stock-based compensation expense as follows:

	2004	2002	2001
Pre-tax	\$407	\$435	\$385
After-tax	\$293	\$313	\$262
Per share	\$0.16	\$0.17	\$0.14

\* Fiscal year 2000 was not restated for this adoption.

\* Includes Quaker merger-related costs of:

	2003	2002	2001
Pre-tax	\$59	\$224	\$356
After-tax	\$42	\$190	\$322
Per share	\$0.02	\$0.11	\$0.18

\* The 2000 fiscal year consisted of fifty-three weeks compared to fifty-two weeks in our normal fiscal year. The 53rd week increased 2000 net revenue by an estimated \$294 million and net income by an estimated \$44 million (or \$0.02 per share).

\* Cash dividends per common share are those of pre-merger PepsiCo prior to the effective date of the merger.

\* In the fourth quarter of 2004, we reached agreement with the IRS for an open issue related to our discontinued restaurant operations which resulted in a tax benefit of \$38 million or \$0.02 per share.

## Reconciliation of GAAP and Non-GAAP Information

We recognized certain tax benefits in the third and fourth quarters of 2004. In addition, we incurred restructuring and impairment charges in the fourth quarter of 2004 related to Frito-Lay's manufacturing consolidation, as well as restructuring charges in the fourth quarter of 2003 in conjunction with the streamlining of our North American divisions and PepsiCo International.

Net income and earnings per share excluding the impact of these tax benefits and the restructuring and impairment charges are not measures defined by generally accepted accounting principles (GAAP). We believe investors should consider our net income and earnings per share without the impact of these tax benefits and the restructuring and impairment charges as these measures are more indicative of our ongoing performance.

### Net Income Reconciliation

	2004	2003	Growth
Reported net income	\$4,212	\$3,568	18%
Tax benefits	(304)	(109)	
Restructuring and impairment charges	96	100	
Net income excluding tax benefits and restructuring and impairment charges	\$4,004	\$3,560*	12%

\*Based on unrounded amounts.

### Diluted EPS Reconciliation

	2004	2003	Growth
Reported diluted EPS	\$2.44	\$2.05	19%
Impact of tax benefits	(0.18)	(0.06)	
Restructuring and impairment charges	0.06	0.06	
Diluted EPS excluding tax benefits and restructuring and impairment charges	\$2.32	\$2.05	13%

## GLOSSARY

**Anchor bottlers:** The Pepsi Bottling Group (PBG), PepsiAmericas, Inc. (PAS) and Pepsi Bottling Ventures (PBV).

**Bottler:** customers who have granted exclusive contracts to sell and manufacture certain beverage products bearing our trademarks within a specific geographical area.

**Bottler Case Sales (BCS):** measure of physical 8 oz. case volume of beverages bearing our trademarks that bottlers have sold to independent distributors and retailers. BCS is reported on a monthly basis.

**Bottler funding:** financial incentives we give to our bottlers to assist in the distribution and promotion of our beverage products.

**Business Process Transformation (BPT):** our comprehensive multi-year effort to drive efficiencies. It includes efforts to physically consolidate, or hardwire, key business functions to take advantage of our scale. It also includes moving to a common set of processes that underlie our key activities, and supporting them with common technology application. And finally, it includes our SAP installation, the computer system that will link all of our systems and processes.

**Concentrate Shipments and Equivalents (CSE):** measure of our physical beverage volume to our customers. This measure is reported on our fiscal year basis.

**Consumers:** people who eat and drink our products.

**Customers:** franchise bottlers and independent distributors and retailers.

**CSD:** carbonated soft drinks.

**Derivatives:** financial instruments, such as Chicago Board of Trade commodity futures and options, that we use to manage our risk arising from changes in commodity prices, interest rates, foreign exchange rates and stock prices.

**Direct-Store-Delivery (DSD):** delivery system used by us and our bottlers to deliver snacks and beverages directly to retail stores where our products are merchandised.

**Effective net pricing:** reflects the year-over-year impact of discrete pricing actions, sales incentive activities and mix resulting from selling varying products in different package sizes and in different countries.

**Management operating cash flow:** net cash provided by operating activities less capital spending plus sales of property, plant and equipment. It is our primary measure used to monitor cash flow performance.

**Marketplace spending:** sales incentives offered through various programs to our customers and consumers, as well as advertising and other marketing activities.

**Power of One:** our initiative that enables us to leverage all of our products, services and talents for the advantage of our retail partners.

**Servings:** common metric reflecting our consolidated physical unit volume. Our divisions' physical unit measures are converted into servings based on U.S. Food and Drug Administration guidelines for single-serving sizes of our products.

**Smart Spot:** our initiative that helps consumers find our products that can contribute to healthier lifestyles.

**Transaction gains and losses:** the impact on our consolidated financial statements of exchange rate changes arising from specific transactions.

**Translation adjustments:** the impact of the conversion of our foreign affiliates' financial statements to U.S. dollars for the purpose of consolidating our financial statements.



**PEPSICO**



700 Anderson Hill Road  
Purchase, New York 10577-1444

March 24, 2005

Dear Fellow PepsiCo Shareholder:

You are invited to attend our Annual Meeting of Shareholders on Wednesday, May 4, 2005, at 11:00 a.m. local time at the headquarters of Frito-Lay, Inc., 7701 Legacy Drive, Plano, Texas.

At the meeting, we will ask you to elect the Board of Directors, to ratify the appointment of independent auditors, and to consider one shareholder proposal. We will also review the progress of the Company during the past year and answer your questions. The attached Proxy Statement describes the business we will conduct and provides information about the Company that you should consider when you vote your shares.

Cordially,

Steven S Reinemund







**PEPSICO**



## NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

PepsiCo will hold its Annual Meeting of Shareholders at the headquarters of Frito-Lay, Inc., 7701 Legacy Drive, Plano, Texas, on Wednesday, **May 4, 2005**, at **11:00 a.m.** local time, to:

- Elect the Board of Directors.
- Ratify the appointment of independent auditors.
- Act upon one shareholder proposal described in the attached Proxy Statement.
- Transact any other business that may properly come before the Meeting.

Holders of record of the Company's Common and Convertible Preferred Stock as of the close of business on March 11, 2005 (the "Record Date") will be entitled to vote at the Meeting.

Please refer to the General Information page in this Proxy Statement for additional information about the Annual Meeting and voting.

March 24, 2005

Larry D. Thompson  
Secretary



## GENERAL INFORMATION ABOUT THE ANNUAL MEETING AND VOTING

### Who can attend the Annual Meeting?

Only shareholders of record as of the close of business on March 11, 2005, their authorized representatives and guests will be able to attend the Annual Meeting. Admission will be by ticket only, and those attending the Annual Meeting must bring photo identification. Frito-Lay headquarters is accessible to disabled persons. Upon request, we will provide wireless headsets for hearing amplification.

### How do I receive an admission ticket?

If you are a registered shareholder (your shares are held in your name) and plan to attend the Annual Meeting, you can obtain an admission ticket by checking the appropriate box on your enclosed proxy card or by contacting PepsiCo's Manager of Shareholder Relations at (914) 253-3055. An admission ticket will then be sent to you.

If you are a beneficial owner (your shares are held in the name of a bank, broker or other holder of record) and plan to attend the Annual Meeting, you can obtain an admission ticket in advance by writing to Investor Relations, PepsiCo, Inc., 700 Anderson Hill Road, Purchase, NY 10577 or by contacting PepsiCo's Manager of Shareholder Relations at (914) 253-3055. Please be sure to include proof of ownership, such as a bank or brokerage account statement. Shareholders who do not obtain tickets in advance may obtain them upon verification of their ownership at the registration desk on the day of the Annual Meeting.

### How do I vote at the Annual Meeting?

If you wish to vote at the Annual Meeting, written ballots will be available from the ushers at the meeting. If your shares are held in the name of a bank, broker or other holder of record and you decide to attend and vote at the Annual Meeting, you must obtain a proxy, executed in your favor, from the holder of record to be able to vote at the meeting. However, if you vote by proxy and also attend the meeting, there is no need to vote again at the Annual Meeting unless you wish to change your vote.

### How do I vote if I am a registered shareholder and cannot attend the Annual Meeting?

All shareholders who are entitled to vote on the matters that come before the Annual Meeting have the opportunity to do so whether or not they attend the meeting in person. If you hold your shares through a bank, broker or other holder of record, please refer to the information provided by that entity for instructions on how to vote your shares. If you are a registered shareholder and are unable to attend the Annual Meeting, you can vote your shares by proxy in one of the following manners:

**Via Internet** at <https://www.proxyvotenow.com/pep> and following the instructions;

**By Telephone** at 1-866-358-4697 in the United States, Canada or Puerto Rico on a touch-tone phone and following the recorded instructions; or

**By Mail** by signing and returning the enclosed proxy card.

Choosing to vote via the Internet or calling the toll-free number listed on the proxy card will save the Company expense. Instructions for using these convenient services appear on the proxy card. You can also vote your shares by marking your votes on the proxy card, signing and dating it and mailing it promptly using the envelope provided. Proxy votes are tabulated by an independent agent and reported at the Annual Meeting.

### **Can I Revoke My Proxy?**

You may revoke your proxy by casting a ballot at the Annual Meeting. Any proxy not revoked will be voted as specified on your proxy card. If you return your proxy and no vote is specified (and you do not withhold authority for a nominee or you do not indicate that you abstain), your proxy will be voted in accordance with the Board of Directors' recommendations.

### **Can Employees Who Participate in PepsiCo's 401(k) Plan Vote?**

Employees who participate in PepsiCo's 401(k) plan (a portion of which constitutes an Employee Stock Ownership Plan (the "ESOP")) can vote the shares held in the 401(k) plan as of the close of business on March 11, 2005. To do so, the employee participant must sign and return a proxy card as instructed in the proxy materials. If cards representing shares held in the 401(k) plan are not returned, the trustees will not vote those shares for which signed cards are not returned, unless required by law.

### **What Constitutes a Quorum at the Annual Meeting?**

Under North Carolina law and the Company's By-laws, the presence in person or by proxy of the holders of record of a majority of the votes entitled to be cast constitutes a quorum. Abstentions and broker non-votes are counted as present to determine whether a quorum exists at the meeting.

### **How are Votes Counted?**

**Election of Directors.** Under North Carolina law and the Company By-laws, the nominees for directors who receive a majority of all the votes cast shall be elected to the Board of Directors.

**Ratification of Independent Auditors.** Under North Carolina law and the Company By-laws, ratification of the appointment of the independent auditors will be approved if a majority of all the votes cast are in favor of ratification.

**Shareholder Proposal.** For the shareholder proposal, the affirmative vote of a majority of the votes cast is required for adoption of the resolution.

**Note on Abstentions.** If you abstain from voting on a particular matter, your vote will not be treated as present and, therefore, will not be treated as cast either for or against that proposal.

**Note on "Broker Non-Votes."** The rules of the New York Stock Exchange determine whether a broker may cast votes related to shares held by the broker for the benefit of the actual owner where the broker does not receive specific voting instructions from the actual owner. On routine matters, such as the Election of Directors, Ratification of Independent Auditors, brokers may cast a vote on such shares. On nonroutine matters, such as the Shareholder Proposals, brokers may not vote such shares and these "broker non-votes" will not be treated as present.

### **Are My Votes Confidential?**

PepsiCo's policy is that proxies identifying individual shareholders are private except as necessary to determine compliance with law or assert or defend legal claims. Proxies may also not be kept confidential in a contested proxy solicitation or in the event that a shareholder makes a written comment on a proxy card or an attachment to it. PepsiCo retains an independent organization to tabulate shareholder votes and certify voting results. The tabulating agent maintains the confidentiality of the proxies throughout the process.



March 24, 2005

## PROXY STATEMENT

The Board of Directors of PepsiCo, Inc. ("PepsiCo" or the "Company") is soliciting proxies to be voted at the Annual Meeting of Shareholders to be held on Wednesday, May 4, 2005, and at any adjournment of the Meeting. We are sending this Proxy Statement in connection with the proxy solicitation.

PepsiCo's authorized stock includes both Common Stock and Convertible Preferred Stock. As of March 11, 2005, the record date, there were 1,677,975,648 shares of PepsiCo Common Stock outstanding and entitled to one vote each at the Annual Meeting and 407,853 shares of PepsiCo Convertible Preferred Stock outstanding and entitled to 2,023,971 votes at the Annual Meeting, which number is equal to the number of shares of Common Stock into which such shares of Convertible Preferred Stock could be converted on the record date, rounded to the nearest one-tenth. Holders of the Common Stock and the Convertible Preferred Stock vote together on all matters as a single class. The outstanding shares of Common Stock were registered in the names of 208,039 shareholders and the outstanding shares of Convertible Preferred Stock were registered in the names of 3,159 shareholders. As far as we know, no person owns beneficially more than 5% of the outstanding Common or Convertible Preferred Stock.

PepsiCo is making its first mailing of this Proxy Statement on or about March 24, 2005.

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## **ELECTION OF DIRECTORS (PROXY ITEM NO. 1)**

The Board of Directors proposes the following twelve nominees for election as directors at the Annual Meeting. The directors will hold office from election until the next Annual Meeting of Shareholders, or until their successors are elected and qualified. If any of these nominees for director becomes unavailable, the persons named in the enclosed proxy intend to vote for any alternate designated by the current Board of Directors. If all of the twelve director nominees are elected, the Board of Directors will have one vacancy since one of the incumbent directors will not stand for re-election. There are no plans to fill the vacancy at this time. Proxies cannot be voted for a greater number of persons than the nominees named.



**JOHN F. AKERS**, 70, former Chairman of the Board and Chief Executive Officer of International Business Machines Corporation, has been a member of PepsiCo's Board since 1991 and is Chairman of its Compensation Committee. Mr. Akers joined IBM in 1960 and was Chairman and Chief Executive Officer from 1986 until 1993. He is also a director of Hallmark Cards, Inc., Lehman Brothers Holdings Inc., The New York Times Company, and W.R. Grace & Co.



**ROBERT E. ALLEN**, 70, former Chairman of the Board and Chief Executive Officer of AT&T Corp., has been a member of PepsiCo's Board since 1990 and is Chairman of its Nominating and Corporate Governance Committee. He began his career at AT&T in 1957 when he joined Indiana Bell. He was elected President and Chief Operating Officer of AT&T Corp. in 1986, and was Chairman and Chief Executive Officer from 1988 until 1997. He is also a director of Bristol-Myers Squibb Company, and a Trustee of The Mayo Foundation and Wabash College.



**RAY L. HUNT**, 61, Chief Executive Officer of Hunt Oil Company and Chairman, Chief Executive Officer and President, Hunt Consolidated, Inc., was elected to PepsiCo's Board in 1996. Mr. Hunt began his association with Hunt Oil Company in 1958 and has held his current position since 1976. He is also a director of Halliburton Company, Electronic Data Systems Corporation, King Ranch, Inc., Verde Group, LLC and Chairman of the Board of Directors of the Federal Reserve Bank of Dallas.



**ARTHUR C. MARTINEZ**, 65, former Chairman of the Board, President and Chief Executive Officer of Sears, Roebuck and Co., was elected to PepsiCo's Board in 1999. Mr. Martinez was Chairman and Chief Executive Officer of the former Sears Merchandise Group from 1992 to 1995 and served as Chairman of the Board, President and Chief Executive Officer of Sears, Roebuck and Co. from 1995 until 2000. He served as Vice Chairman and a director of Saks Fifth Avenue from 1990 to 1992. He is also a director of Liz Claiborne, Inc. and International Flavors & Fragrances Inc. Mr. Martinez is a member of the Supervisory Board of ABN AMRO Holding, N.V.

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**INDRA K. NOOYI**, 49, was elected to PepsiCo's Board and became President and Chief Financial Officer in May 2001, after serving as Senior Vice President and Chief Financial Officer since February 2000. Ms. Nooyi also served as Senior Vice President, Strategic Planning and Senior Vice President, Corporate Strategy and Development from 1994 until 2000. Prior to joining PepsiCo, Ms. Nooyi spent four years as Senior Vice President of Strategy, Planning and Strategic Marketing for Asea Brown Boveri, Inc. She was also Vice President and Director of Corporate Strategy and Planning at Motorola, Inc. Ms. Nooyi is also a director of Motorola, Inc.

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**STEVEN S. REINEMUND**, 56, has been PepsiCo's Chairman and Chief Executive Officer since May 2001. He was elected a director of PepsiCo in 1996 and before assuming his current position, served as President and Chief Operating Officer from September 1999 until May 2001. Mr. Reinemund began his career with PepsiCo in 1984 as a senior operating officer of Pizza Hut, Inc. He became President and Chief Executive Officer of Pizza Hut in 1986, and President and Chief Executive Officer of Pizza Hut Worldwide in 1991. In 1992, Mr. Reinemund became President and Chief Executive Officer of Frito-Lay, Inc., and Chairman and Chief Executive Officer of the Frito-Lay Company in 1996. Mr. Reinemund is also a director of Johnson & Johnson.

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**SHARON PERCY ROCKEFELLER**, 60, was elected a director of PepsiCo in 1986. She is President and Chief Executive Officer of WETA public stations in Washington, D.C., a position she has held since 1989, and was a member of the Board of Directors of WETA from 1985 to 1989. She is a member of the Board of Directors of Public Broadcasting Service, Washington, D.C. and was a member of the Board of Directors of the Corporation for Public Broadcasting until 1992. Mrs. Rockefeller is also a director of Sotheby's Holdings, Inc.

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**JAMES J. SCHIRO**, 59, was elected to PepsiCo's Board in January 2003. Mr. Schiro became Chief Executive Officer of Zurich Financial Services in May 2002, after serving as Chief Operating Officer – Group Finance since March 2002. He joined Price Waterhouse in 1967, where he held various management positions. In 1994 he was elected Chairman and senior partner of Price Waterhouse, and in 1998 became Chief Executive Officer of PricewaterhouseCoopers, after the merger of Price Waterhouse and Coopers & Lybrand.

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**FRANKLIN A. THOMAS**, 70, was elected to PepsiCo's Board in 1994. From 1967 to 1977, he was President and Chief Executive Officer of the Bedford-Stuyvesant Restoration Corporation. From 1977 to 1979 Mr. Thomas had a private law practice in New York City. Mr. Thomas was President of the Ford Foundation from 1979 to April 1996 and is currently a consultant to the TFF Study Group, a non-profit organization assisting development in southern Africa. He is also a director of ALCOA Inc., Citigroup Inc., and Lucent Technologies Inc.

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**CYNTHIA M. TRUDELL**, 51, President of Sea Ray Group since 2001, was elected to PepsiCo's Board in January 2000. From 1999 until 2001, Ms. Trudell served as General Motors' Vice President, and Chairman and President of Saturn Corporation, a wholly owned subsidiary of GM. Ms. Trudell began her career with the Ford Motor Co. as a chemical process engineer. In 1981, she joined GM and held various engineering and manufacturing supervisory positions. In 1995, she became plant manager at GM's Wilmington Assembly Center in Delaware. In 1996, she became President of IBC Vehicles in Luton, England, a joint venture between General Motors and Isuzu.

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**SOLOMON D. TRUJILLO**, 53, former Chairman and Chief Executive Officer of Orange SA, was elected to PepsiCo's Board in January 2000. Previously, Mr. Trujillo was Chairman, Chief Executive Officer and President of Graviton, Inc. from November 2000, Chairman of US WEST from May 1999, and President and Chief Executive Officer of US WEST beginning in 1998. He served as President and Chief Executive Officer of US WEST Communications Group and Executive Vice President of US WEST from 1995 until 1998 and President and Chief Executive Officer of US WEST Dex, Inc. from 1992 to 1995. Mr. Trujillo is also a director of Electronic Data Systems Corporation, Gannett Co., Inc. and Target Corporation.

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**DANIEL VASELLA**, 51, was elected to PepsiCo's Board in February 2002. Dr. Vasella became Chairman of the Board and Chief Executive Officer of Novartis AG in 1999, after serving as President since 1996. From 1992 to 1996, Dr. Vasella held the positions of Chief Executive Officer, Chief Operating Officer, Senior Vice President and Head of Worldwide Development and Head of Corporate Marketing at Sandoz Pharma Ltd. He also served at Sandoz Pharmaceuticals Corporation from 1988 to 1992.

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## **OWNERSHIP OF PEPSICO COMMON STOCK BY DIRECTORS AND EXECUTIVE OFFICERS**

The following table shows, as of March 11, 2005, the shares of PepsiCo Common Stock beneficially owned by each director (including each nominee), by each of our five most highly compensated executive officers, and by all directors and all executive officers as a group:

<u>Name of Individual or Group</u>	<u>Number of Shares of PepsiCo Common Stock Beneficially Owned(1)</u>
John F. Akers .....	91,722
Robert E. Allen .....	54,133
Abelardo E. Bru .....	625,114
Ray L. Hunt (2) .....	531,897
Arthur C. Martinez .....	25,645
Indra K. Nooyi .....	832,722
Franklin D. Raines .....	30,504
Steven S Reinemund (2) .....	3,225,027
Sharon Percy Rockefeller .....	83,373
Gary M. Rodkin .....	897,819
James J. Schiro .....	12,462
Franklin A. Thomas .....	43,883
Cynthia M. Trudell .....	26,866
Solomon D. Trujillo .....	41,762
Daniel Vasella .....	15,584
Michael D. White .....	807,559
All directors and executive officers as a group (22 persons) .....	8,727,704

- (1) The shares shown include the following shares that directors and executive officers have the right to acquire within 60 days after March 11, 2005 through the exercise of vested stock options: John F. Akers, 66,711 shares; Robert E. Allen, 46,997 shares; Abelardo E. Bru, 615,960 shares; Ray L. Hunt, 65,911 shares; Arthur C. Martinez, 23,645 shares; Indra K. Nooyi, 818,809 shares; Franklin D. Raines, 29,504 shares; Steven S Reinemund, 3,114,393 shares; Sharon Percy Rockefeller, 38,508 shares; Gary M. Rodkin, 893,783 shares; James J. Schiro, 10,377 shares; Franklin A. Thomas, 42,883 shares; Cynthia M. Trudell, 26,866 shares; Solomon D. Trujillo, 37,762 shares; Daniel Vasella, 10,417 shares; Michael D. White, 767,982 shares; and all directors and executive officers as a group, 7,941,299 shares.
- (2) The shares shown for Mr. Hunt include (i) 26,700 shares held in a corporation over which Mr. Hunt has sole voting and investment power, (ii) 262,286 shares held in trusts over which Mr. Hunt has shared voting power and sole investment power, and (iii) 152,500 shares held in a trust over which Mr. Hunt has sole voting power and no investment power. The shares shown for Mr. Reinemund include 103,631 shares over which Mr. Reinemund shares voting and investment power with his spouse.

The following table shows, as of March 11, 2005, the number of PepsiCo Common Stock equivalents held in the PepsiCo deferred income program by each director (including each nominee), by each of our five most highly compensated executive officers, and by all directors and all executive officers as a group:

<u>Name of Individual or Group</u>	<u>Number of PepsiCo Common Stock Equivalents Held in PepsiCo's Deferred Income Program</u>
John F. Akers .....	9,617
Robert E. Allen .....	17,696
Abelardo E. Bru .....	0
Ray L. Hunt .....	9,211
Arthur C. Martinez .....	13,522
Indra K. Nooyi .....	49,682
Franklin D. Raines .....	12,126
Steven S. Reinemund .....	234,505
Sharon Percy Rockefeller .....	0
Gary M. Rodkin .....	43,204
James J. Schiro .....	2,056
Franklin A. Thomas .....	13,273
Cynthia M. Trudell .....	7,721
Solomon D. Trujillo .....	6,521
Daniel Vasella .....	0
Michael D. White .....	0
All directors and executive officers as a group (22 persons) .....	419,134

Directors and executive officers as a group own less than 1% of outstanding PepsiCo Common Stock. No directors or executive officers own any PepsiCo Convertible Preferred Stock.

## **CORPORATE GOVERNANCE AT PEPSICO**

### ***Board of Directors***

Our business and affairs are overseen by our Board of Directors pursuant to the North Carolina Business Corporation Act and our By-Laws. Members of the Board of Directors are kept informed of the Company's business through discussions with the Chairman and Chief Executive Officer, and with key members of management, by reviewing materials provided to them and by participating in Board and Committee meetings. Members of the Board of Directors are elected annually.

Regular attendance at Board meetings is required of each Director. PepsiCo's Board held six meetings during 2004. Average attendance by incumbent directors at Board and standing Committee meetings was 98%. No incumbent director attended fewer than 75% of the total number of Board and standing Committee meetings. The non-employee directors met in executive session at all six Board meetings in 2004. All Directors attended the 2004 Annual Meeting.

In 2002, the Board of Directors adopted Corporate Governance Guidelines. These Guidelines were amended in 2004 in accordance with the revised New York Stock Exchange Listing Standards and rules adopted by the Securities and Exchange Commission. The revised Guidelines are attached to this Proxy Statement as Exhibit A and are also available on the Company's website at [www.pepsico.com](http://www.pepsico.com) under Corporate Governance in the "Investors" section and are available in print to any shareholder who requests a copy. The Company's Worldwide Code of Conduct is also available on the Company's website at [www.pepsico.com](http://www.pepsico.com) under Corporate Governance in the "Investors" section and is available in print to any shareholder who requests a copy. Annually, all of PepsiCo's executive officers, other senior employees and directors sign certifications with respect to their compliance with the Company's Worldwide Code of Conduct.

## ***Director Independence***

The Board of Directors has determined that the following non-employee directors standing for re-election have met the independence standards within the meaning of the rules of the New York Stock Exchange, based on the application of the Company's categorical independence standards that were recommended by the Nominating and Corporate Governance Committee and adopted by the Board of Directors, as detailed in the Corporate Governance Guidelines attached as Exhibit A to this Proxy Statement:

John F. Akers	Sharon Percy Rockefeller	Solomon D. Trujillo
Robert E. Allen	James J. Schiro	Daniel Vasella
Ray L. Hunt	Franklin A. Thomas	
Arthur C. Martinez	Cynthia M. Trudell	

No Director receives any fees from the Company other than those received in his or her capacity as a Director.

## ***Presiding Director***

In September 2002, the Board of Directors appointed Robert E. Allen, the Chairman of our Nominating and Corporate Governance Committee, the Presiding Director of the Board. In his capacity as the Presiding Director, Mr. Allen presides at the regularly-scheduled executive sessions of the Board, at which only non-employee directors are present. He also advises the Chairman of the Board and, as appropriate, Committee chairs with respect to agendas and information needs relating to the Board and Committee meetings, and performs other duties that the Board may from time to time delegate to assist the Board in the fulfillment of its responsibilities. Shareholders may communicate with Mr. Allen by sending a letter addressed to PepsiCo, Inc., 700 Anderson Hill Road, Purchase, New York, 10577, Attention: Presiding Director, or by utilizing one of the means through which the Board may be contacted, as provided at [www.pepsico.com](http://www.pepsico.com) under "Contacts."

## ***Communications to the Board of Directors***

The Board of Directors has established a process for contacting the Board or an individual member of the Board. The means through which the Board may be contacted are provided at [www.pepsico.com](http://www.pepsico.com) under "Contacts." All communications to the Board of Directors will be reviewed by the PepsiCo Corporate Law Department. The Corporate Law Department will maintain a log of all communications and will regularly provide a summary and copies of communications to the Board that relate to the functions of the Board or a Board committee or that otherwise require Board attention. Directors may at any time review the log of Board communications received by the Company and request copies or summaries of such communications. In addition, the Corporate Law Department may forward certain communications only to the Presiding Director, the Chair of the relevant committee or the individual Board member to whom a communication is directed. Complaints or concerns relating to PepsiCo's accounting, internal accounting controls or auditing matters will be referred directly to members of the Audit Committee.

## ***Exercise and Hold Policy and Stock Ownership Guidelines***

To ensure that our senior executives exhibit a strong commitment to PepsiCo share ownership, the Board of Directors adopted an Exercise and Hold Policy and Stock Ownership Guidelines that apply to all directors and certain senior executives of the Company. Under the Exercise and Hold Policy, the aggregate amount of cash that may be received by an individual upon the exercise of stock options during each calendar year is limited to 20% of the pre-tax gains on all vested outstanding options as of February 1 of that year. Amounts in excess of the 20% limit must be held in PepsiCo shares for at least one year after exercise. Under the Company's Stock Ownership Guidelines, certain senior executives and directors are required to own PepsiCo stock worth between two times and eight times base compensation, depending on their position.

### **Committees of the Board of Directors**

The Board of Directors has three standing committees: Audit, Compensation, and Nominating and Corporate Governance. The table below indicates the members of each Board committee standing for re-election:

Name	Nominating and Corporate Governance	Compensation	Audit
John F. Akers	X	Chair	
Robert E. Allen*	Chair	X	
Ray L. Hunt	X	X	
Arthur C. Martinez**			X
Indra K. Nooyi			
Steven S. Reinemund			
Sharon P. Rockefeller	X	X	
James J. Schiro			X
Franklin A. Thomas			X
Cynthia M. Trudell			X
Solomon D. Trujillo			X
Daniel Vasella	X	X	

\* Mr. Allen is the Presiding Director of our Board.

\*\* Mr. Martinez serves as Acting Chairman of the Audit Committee.

### **The Nominating and Corporate Governance Committee**

The Nominating and Corporate Governance Committee, which was established in 1997 and renamed in 2002, held three meetings in 2004. The Nominating and Corporate Governance Committee: (a) identifies and recommends to the Board for election and/or appointment qualified candidates for membership on the Board and the committees of the Board; (b) develops and recommends to the Board corporate governance principles and the Worldwide Code of Conduct applicable to the Company and monitors compliance with all such principles and policies; (c) develops and recommends to the Board criteria to assess the independence of members of the Board; (d) makes recommendations to the Board concerning the composition, size, structure and activities of the Board and its committees; (e) assesses and reports to the Board on the performance and effectiveness of the Board and its committees; and (f) reviews and reports to the Board with respect to director compensation and benefits. The Nominating and Corporate Governance Committee Charter is available on the Company's website at [www.pepsico.com](http://www.pepsico.com) under Corporate Governance in the "Investors" section and is also available in print to any shareholder who requests a copy. The Nominating and Corporate Governance Committee is comprised entirely of directors who meet the independence requirements of the New York Stock Exchange and applicable securities laws.

### **Director Nomination Process**

The Nominating and Corporate Governance Committee does not solicit director nominations, but will consider recommendations, from shareholders. Such recommendations should be sent to the Secretary of PepsiCo at 700 Anderson Hill Road, Purchase, New York 10577. As set forth in the Company's Corporate Governance Guidelines (attached as Exhibit A), when seeking candidates for the Board of Directors, the Nominating and Corporate Governance Committee will generally look for individuals who have displayed high ethical standards and sound business judgment.

Nominations received by the Secretary of the Company from shareholders are reviewed by the Chairman of the Nominating and Corporate Governance Committee to determine whether the candidate possesses the minimum qualifications set forth in the Corporate Governance Guidelines, and if so, whether the candidate's expertise and particular set of skills and background fit the current needs of the Board. If the candidate meets the requirements for a current vacancy on the Board, the submission materials are reviewed with the Nominating and Corporate Governance Committee and are responded to by the Chairman of the Committee or his designee.



The process of reviewing and evaluating candidates submitted by shareholders is designed to ensure that the Board includes members with diverse backgrounds, skills and experience, including appropriate financial and other expertise relevant to the business of the Company. The process for evaluation of candidates submitted by non-shareholders of the Company is handled similarly.

From time to time, the Nominating and Corporate Governance Committee engages consulting firms to perform searches for director candidates who meet the current needs of the Board. If a consulting firm is retained to assist in the search process for a director, a fee is typically paid to such firm only if the candidate is elected to the Board or is recommended to the Board by the Nominating and Corporate Governance Committee for inclusion in the slate of nominees to be elected at the Annual Meeting of Shareholders.

### ***The Audit Committee***

The Audit Committee, which was established in 1967, held seven meetings in 2004. The Audit Committee's primary responsibilities are to assist the Board's oversight of: (a) the quality and integrity of the Company's financial statements and its related internal controls over financial reporting; (b) the Company's compliance with legal and regulatory requirements; (c) the independent auditor's qualifications and independence; and (d) the performance of the Company's internal audit function and the independent auditors. The report of the Audit Committee is set forth on page 10 of this Proxy Statement. The Audit Committee Charter is attached as Exhibit B to this Proxy Statement and is available on the Company's website at [www.pepsico.com](http://www.pepsico.com) under Corporate Governance in the "Investors" section and is also available in print to any shareholder who requests a copy.

#### ***Financial Expertise***

The Board of Directors has determined that Arthur C. Martinez and James J. Schiro, members of our Audit Committee, satisfy the criteria adopted by the Securities and Exchange Commission to serve as "audit committee financial experts" and are independent directors, pursuant to the standards set forth in the Company's Corporate Governance Guidelines and the requirements under the Securities Exchange Act of 1934 and the New York Stock Exchange Listing Standards. In addition, the Board of Directors has determined that Arthur C. Martinez, James J. Schiro, Franklin A. Thomas, Cynthia M. Trudell and Solomon D. Trujillo, all members of our Audit Committee, are financially literate within the meaning of the New York Stock Exchange Listing Standards.

#### ***Directors on Multiple Audit Committees***

Mr. Arthur C. Martinez serves as a member of the audit committee of four public companies, including the Company. The Board of Directors has determined that Mr. Martinez's simultaneous service on the audit committees of more than three public companies does not impair his ability to serve effectively on the Company's Audit Committee.

### ***The Compensation Committee***

The Compensation Committee, which has been active since 1955, held five meetings during 2004. The Compensation Committee: (a) oversees the policies of the Company relating to compensation of the Company's executives and makes recommendations to the Board with respect to such policies; (b) produces a report on executive compensation for inclusion in the Company's Proxy Statement; and (c) monitors the development and implementation of succession plans for the Chief Executive Officer and other key executives, and makes recommendations to the Board with respect to such plans. The Compensation Committee report on executive compensation is set forth on page 12 of this Proxy Statement. The Compensation Committee Charter is available on the Company's website at [www.pepsico.com](http://www.pepsico.com) under Corporate Governance in the "Investors" section and is also available in print to any shareholder who requests a copy.

#### ***Compensation Committee Interlocks and Insider Participation***

None of PepsiCo's independent directors is an executive officer of a public company of which a PepsiCo executive officer is a director.

## **AUDIT COMMITTEE REPORT**

PepsiCo's Audit Committee reports to and acts on behalf of the Board of Directors by providing oversight of the Company's independent auditors and the Company's financial management and financial reporting procedures. The Audit Committee is comprised entirely of directors who meet the independence, financial experience and other qualification requirements of the New York Stock Exchange and applicable securities laws. The Audit Committee operates under a written charter adopted by the Board of Directors, which was reviewed and revised in November 2004 and which is attached as Exhibit B to this Proxy Statement.

The Company's management has responsibility for preparing the Company's financial statements and the Company's independent auditors KPMG LLP ("KPMG"), is responsible for auditing those financial statements. In this context, the Audit Committee has met with management and KPMG to review and discuss the Company's audited financial statements. The Audit Committee discussed with Company management the critical accounting policies applied by the Company in the preparation of its financial statements. These policies arise in conjunction with: revenue recognition; brand and goodwill valuations; income tax expense and accruals; stock compensation expense; and pension and retiree medical plans. The Company's management has represented to the Audit Committee that the financial statements were prepared in accordance with generally accepted accounting principles. The Audit Committee discussed with KPMG the matters required to be discussed by the Statement on Auditing Standards No. 61 (Communications with Audit Committees) and the Sarbanes-Oxley Act of 2002, and had the opportunity to ask KPMG questions relating to such matters. The discussions included the quality, and not just the acceptability, of the accounting principles utilized, the reasonableness of significant accounting judgments, and the clarity of disclosures in the financial statements. The Audit Committee also discussed with Company management the process for certifications by the Company's Chief Executive Officer and Chief Financial Officer, which is required by the Securities and Exchange Commission and the Sarbanes-Oxley Act of 2002 for certain of the Company's filings with the Securities and Exchange Commission.

The Audit Committee reviewed with the Company's internal and independent auditors the overall scope and plans for their respective audits for 2004. The Audit Committee also received regular updates from the Company's General Auditor on internal control and business risks. The Audit Committee meets with the internal and independent auditors, with and without management present, to discuss their evaluations of the Company's internal controls and the overall quality of the Company's financial reporting. The Audit Committee also meets with the Company's General Counsel, with and without management present, to discuss the Company's compliance with laws and regulations.

The Audit Committee reviewed and discussed with KPMG, KPMG's independence and, as part of that review, received the written disclosures and letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and by all relevant professional and regulatory standards relating to KPMG's independence from the Company. The Audit Committee also reviewed and pre-approved all fees paid to the independent auditors. These fees are described in the next section of this Proxy Statement. The Audit Committee also considered whether KPMG's provision of non-audit services to the Company was compatible with the auditor's independence. The Committee has adopted a formal policy on Audit, Audit Related and Non-Audit Services, which is published on the Company's website and which is briefly described in the next section of this Proxy Statement. The Audit Committee concluded that the independent auditor is independent from the Company and its management.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board has approved, that the audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended December 25, 2004, for filing with the Securities and Exchange Commission. The Audit Committee has also retained KPMG as the Company's independent auditors for the fiscal year 2005, and the Audit Committee and the Board have recommended that shareholders ratify the appointment of KPMG as the Company's independent auditors for the fiscal year 2005.

On January 27, 2005, the Company's Board of Directors accepted the offer of Franklin D. Raines not to stand for re-election to the Board of Directors at the Annual Meeting. Mr. Raines continues to serve as a member of the Board of Directors and Chairman of the Company's Audit Committee until the Annual Meeting, but will refrain from participating in Committee proceedings that pose a potential conflict of interest, including proceedings regarding the evaluation, selection or approval of the Company's independent auditors for the fiscal year 2005.

### **THE AUDIT COMMITTEE**

FRANKLIN D. RAINES, CHAIRMAN  
ARTHUR C. MARTINEZ  
JAMES J. SCHIRO

FRANKLIN A. THOMAS  
CYNTHIA M. TRUDELL  
SOLOMON D. TRUJILLO

### **AUDIT AND NON-AUDIT FEES**

The following table presents fees for professional audit services rendered by KPMG LLP, the Company's independent auditor, for the audit of the Company's annual financial statements for 2003 and 2004, and fees billed for other services rendered by KPMG LLP.

	<u>2003</u>	<u>2004</u>
Audit fees (1)	\$10,313,000(4)	\$18,589,000
Audit-related fees (2)	\$ 1,799,000	\$ 3,714,000
Tax fees (3)	\$ 1,041,000	\$ 1,165,000
All other fees	\$ 0	\$ 0

- (1) Audit fees for 2004 include the audit of the Company's internal controls over financial reporting in compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The increase in 2004 fees was primarily related to services in connection with Section 404 of the Sarbanes-Oxley Act of 2002.
- (2) Audit-related fees for 2003 and 2004 consisted primarily of the audits of certain employee benefit plans, due diligence reviews of certain businesses acquired, internal control reviews, and advice related to the Company's preparation for compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The increase in 2004 fees was primarily related to services in connection with Section 404 of the Sarbanes-Oxley Act of 2002.
- (3) Tax fees for 2003 and 2004 consisted primarily of international tax compliance services.
- (4) The Audit fees for 2003 include an additional \$549,000 relating to audit fees paid locally, which were not included in the total for Audit fees as reported in our 2004 Proxy Statement.

We understand the need for the independent auditors to maintain their objectivity and independence, both in appearance and in fact, in their audit of the Company's financial statements. Accordingly, the Audit Committee has adopted the PepsiCo Policy for Audit, Audit-Related and Non-Audit Services. The Policy provides that the Audit Committee will engage the auditor for the audit of the Company's consolidated financial statements and other audit-related work. The auditor may also be engaged for tax and other non-audit related work if those services: enhance and support the attest function of the audit; are an extension to the audit or audit related services; or are services with respect to which, under the circumstances, KPMG offers unique qualification and there is clearly no question

regarding their independence in providing such service. The policy further provides that on an annual basis the auditor's Global Lead Audit Partner will review with the Audit Committee the services the auditor expects to provide in the coming year and the related fee estimates. In addition, PepsiCo will provide the Audit Committee with a quarterly status report regarding the Committee's pre-approval of audit related, tax or other non-audit services that the auditor has been pre-approved to perform, has been asked to provide or may be expected to provide in the following quarter. PepsiCo's Policy for Audit, Audit-Related and Non-Audit Services is available on the Company's website at [www.pepsico.com](http://www.pepsico.com) under Corporate Governance in the "Investors" section.

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## **DIRECTORS' COMPENSATION**

The Nominating and Corporate Governance Committee reviewed the compensation program for Directors and recommended that the Board maintain the program as described below at the current levels for the period October 2004 through September 2005.

Directors who are employees of the Company receive no additional pay for serving as directors. All other directors receive an annual retainer of \$100,000 and an annual equity award. Committee chairs receive an additional \$10,000 retainer for the supplemental duties associated with serving as a committee chair. All newly appointed directors receive a one-time grant of 1,000 shares of PepsiCo Common Stock when they join the Board. Directors are reimbursed for expenses incurred to attend Board and committee meetings. Directors do not receive any meeting fees, nor do they have a retirement plan or receive any benefits such as life or medical insurance. Directors do receive business travel and accident coverage and are eligible for PepsiCo Foundation matching of charitable contributions.

Directors may elect to receive their retainer in cash or defer their retainer into PepsiCo Common Stock equivalents, which are payable in cash at the end of the deferral period.

The annual equity award to directors is comprised of restricted stock units, stock options, or a combination of both, as elected by each director. In the absence of any election, the award to a director is made all in restricted stock units. The number of restricted stock units awarded is determined by dividing \$75,000 by the fair market value of PepsiCo Common Stock on the date of grant (October 1 in 2004). In substitution of the foregoing, the director may elect to receive all or a portion (in 10% increments) of the award in stock options. If a director elects to receive stock options, the number of stock options awarded is determined by multiplying the number of restricted stock units to be converted by four. Restricted stock units and stock options normally vest after three years and vest earlier in the case of the director's death, disability or retirement. Stock options granted have an exercise price equal to the fair market value of PepsiCo Common Stock on the date of grant.

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## **EXECUTIVE COMPENSATION**

### **COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION**

The Compensation Committee of the Board (the "Committee") oversees PepsiCo's compensation and stock-based programs. The Committee makes recommendations to the Board regarding the compensation of all executive officers and establishes the principles and strategies that guide the design of compensation plans and benefit programs for all employees within PepsiCo. The Board approves all compensation actions regarding the Chief Executive Officer ("CEO") and all other executive officers. The Committee is composed entirely of independent members of the Board.

Annually, with the assistance of independent advisors, who report directly to the Committee, the Committee evaluates PepsiCo's plans and programs against current and emerging competitive practices, legal and regulatory developments and corporate governance trends. In 2004, the review provided assurance that PepsiCo's compensation programs will continue to help attract and retain the talent necessary to maintain our long history of strong sales growth, profitability and shareholder returns.



## ***Compensation Philosophy***

PepsiCo's compensation programs help recruit, retain and motivate a large group of talented and diverse domestic and international employees. The programs are incentive based, and are designed to consider both company and individual performance. As a result, payouts are above market compensation for above market performance and below market compensation for below market performance.

Our philosophy is that PepsiCo will achieve its best results if its employees act and are rewarded as business owners. Ownership is not only about owning stock, but is also about being accountable for business results, in good times and bad. Owners act with the conviction that their business is personal and that they can make a difference. Owners take initiative and they take responsibility for the assets of the business, including its employees. As executives progress to higher levels at PepsiCo, their responsibilities, risks and rewards will progress as well.

Towards these ends, the Committee examines the ongoing competitiveness of PepsiCo's compensation programs, reviews both company and individual executive performance and recommends compensation levels for each executive officer to the Board. The Committee works with outside, independent consultants in establishing the compensation and equity-based programs provided to the CEO, other executive officers, and all PepsiCo employees.

### ***Annually, the Committee:***

- Approves performance targets based on the achievement of specific performance goals, which are either company or business unit focused depending on the executive officer's position and scope of responsibility.
- Ensures that a significant portion of the total compensation package for the CEO, executive officers and other executives are performance-based and that compensation opportunities are designed to create incentives for above-target performance and consequences for below target performance.
- Reviews compensation levels and overall corporate performance against a survey of leading consumer product companies and against surveys of a broader range of major companies, including the Fortune 100. As a part of this work, independent consultants validate that total compensation paid is appropriate based on an analysis that compares PepsiCo's performance to the performance of the peer group using publicly available financial performance measures including long-term shareholder returns over one and three year time periods.
- Approves annual and long-term incentive awards for the year based on performance achieved in the prior year relative to the pre-approved targets. In determining the final awards, the Committee considers objective data concerning PepsiCo's financial performance, including sales volume, revenue, operating profit, cash flow, capital returns and earnings per share. The Committee also considers other strategic achievements, such as improved operating efficiencies, customer and employee satisfaction and talent development.

### ***Stock Ownership and Hold Policy***

To reinforce the Company's ownership philosophy, senior executives are required to own multiples of their salary in PepsiCo stock under the Board approved stock ownership guidelines.

The ownership guidelines operate along with a policy that limits annual option exercises for cash to 20% of vested gains. Any proceeds in excess of this 20% limit must be held in PepsiCo shares for at least one year after the date of exercise.

## ***Specific Compensation Programs***

For 2004, the primary components of PepsiCo's compensation program were base salary, annual incentives, and long-term incentive awards comprised of a combination of stock options and either service based or performance-based restricted stock units. Executive officers also participated in PepsiCo's qualified and nonqualified employee benefit plans. The plans are designed to provide retirement income and are the same as those generally available to other employees. Executive officers, including the CEO, do not have employment contracts.

It is the Committee's intention that substantially all executive compensation be fully deductible for federal income tax purposes. Thus, the Committee ensured that the compensation decisions relating to executive officers were made with full consideration of the implications of Internal Revenue Code Section 162(m). Executive officers generally can defer base salary and annual incentives, subject to applicable law.

**Base Salary.** The relative levels of base salary for the CEO and the other executive officers are based on the underlying accountabilities of each executive's position and reflect each executive officer's scope of responsibility. The salaries are reviewed on a regular basis and are benchmarked against similar positions among the peer group companies. Individual salaries are capped at \$1 million.

**Annual Incentive Compensation.** PepsiCo provides performance-related annual incentive compensation to its executive officers under the shareholder-approved 2004 Executive Incentive Compensation Plan ("2004 EIC Plan"). Awards under the 2004 EIC Plan are intended to constitute "performance-based compensation" under Internal Revenue Code Section 162(m). Provided pre-approved targets are achieved, the Committee may exercise negative discretion to determine the exact amount of the incentive to be paid to each executive officer. In exercising this discretion, the Committee considers a broad range of company and individual performance indicators including PepsiCo's financial results, strategic position and how well the executive manages and develops people. For 2004, the amount of the award an executive was eligible to receive was dependent upon PepsiCo achieving pre-approved earnings per share targets. A payment would not be made if the minimum earnings target was not met.

**Long-Term Incentive Compensation.** Consistent with PepsiCo's compensation philosophy, the Committee believes that stock ownership and stock-based incentive awards are the best way to align the interests of the executive officers with those of PepsiCo's shareholders. PepsiCo has a long history of linking pay to its long-term stock performance for all employees, not just executives. This is best demonstrated by the fact that, since 1989, PepsiCo has provided an annual grant of stock options to virtually all full-time U.S. employees under its broad-based stock option program, SharePower. Target grant guidelines for executive officers are developed based on competitive benchmarking. The actual size of grants awarded to executive officers is based on each officer's individual performance, retention considerations and other special circumstances. The Committee requires that awards made under the long-term incentive plans include vesting terms that encourage an executive officer to remain with PepsiCo over a period of years. All stock option grants have an exercise price equal to the fair market value of PepsiCo Common Stock on the date of grant. There has been no repricing of awards and, under the approved 2003 Long-Term Incentive Plan, any repricing of awards would require shareholder approval.

Historically, following competitive market practice, PepsiCo has utilized stock options as the primary form of long-term incentive compensation. At the end of 2003, the Company voluntarily adopted stock option expensing. Beginning in 2004, consistent with changing market practices that were validated by independent external advisors, the Company reduced the amount of long-term incentives provided to all executives. Concurrent with this change, all executives, except the CEO, were provided with increased performance-based cash incentives. The amount of cash incentives is determined based on achievement of annual performance goals, with payout provided equally over a three year period. Most executives were provided with a choice between stock options and restricted stock units that vest after three years of service. However, PepsiCo's most senior executives, including

the CEO, were not provided with this choice. The value of their long-term incentive compensation was fixed equally between stock options and performance-based restricted stock units. In addition, these senior executives do not receive regular awards of service based restricted stock units. For these executives to realize the awarded value from the restricted stock units, the Company must achieve performance targets each year over a 3-year period. The performance targets during this 3-year period are approved by the Board of Directors. Notwithstanding the attainment of the targets, the Board has the discretion to reduce, but not increase, some or all of an award that would otherwise be paid.

**Benefits.** Executives generally receive the same healthcare and retirement benefits as other employees. Medical benefits are the same for all participants in the Company's health care program; however, executives are required to pay twice as much for their coverage. Because of IRS compensation and benefit limits applicable to the Company's qualified pension plans, a significant portion of executive pensions is typically provided by a non-qualified, unfunded pension plan. Executive deferrals into the 401(k) Plan, and company matching contributions are also limited by IRS regulations. While the Company does permit most executives to defer their base salary and annual incentive compensation, PepsiCo does not provide an excess plan to offset 401(k) limitations nor does it provide executives with special benefit plans such as executive life insurance or a pension with an enhanced formula.

### ***CEO Compensation***

Mr. Reinemund has held the position of Chairman and Chief Executive Officer since May 2001. The Committee recommends and the Board approves Mr. Reinemund's compensation following the general policies and guidelines described above for the compensation of executive officers. The Committee uses competitive information from peer consumer product companies to establish Mr. Reinemund's target compensation package and then uses performance against Board approved objectives to determine his actual compensation.

To establish Mr. Reinemund's target compensation, the Committee compares his salary, bonus and long-term awards to those of peer Company CEOs. PepsiCo's financial performance is also compared to the peer companies on each of the following measures: net revenue, operating income, return on capital, EPS and total shareholder return. For 2004 these comparisons were performed by an independent consultant who validated to the Committee that the CEO's target compensation was appropriate given PepsiCo's financial performance.

To determine Mr. Reinemund's actual compensation, and whether it should be above or below target, the Committee assesses his performance against target objectives approved by the Board in the beginning of the year. For 2004, financial targets included net revenue, EPS, return on invested capital, and cash flow along with a subjective assessment of how the CEO performed against other strategic goals established by the Board.

For the fiscal year 2004, Mr. Reinemund's base salary continued to be capped at \$1,000,000. He was eligible for a 2004 annual incentive award because PepsiCo achieved its pre-approved earnings target. The Committee then exercised its discretion to determine the amount of the award based on Mr. Reinemund's performance against his target objectives during the year. His 2004 incentive award is shown in the bonus column in the Summary Compensation Table that follows.

In February 2004, Mr. Reinemund also received a long-term incentive award which was based on 2003 performance. Part of the award was in stock options, which had an exercise price equal to the fair market value of PepsiCo stock on the day of grant and which vest after three years of service. Part of the award was in performance-based restricted stock units which require that the Company achieve earnings targets over a three year period before the restrictions can be lifted and value received by Mr. Reinemund. The Board of Directors approves the earnings targets in advance, and no payment of awards is made unless the targets are achieved. These awards are shown in the Long-term Compensation columns of the Summary Compensation Table that follows.

## Summary

The Committee believes that PepsiCo's compensation practices and compensation philosophy align executive interests with those of shareholders. As the scope and level of an executive's business responsibilities expand, the portion of their compensation package that is "at risk" also increases.

We believe that the actions taken over the past year have allowed the Company to attract, retain and motivate the key talent PepsiCo needs to continue to compete and provide strong return to shareholders.

## THE COMPENSATION COMMITTEE

JOHN F. AKERS  
ROBERT E. ALLEN  
RAY L. HUNT

SHARON PERCY ROCKEFELLER  
DANIEL VASELLA

## SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation(2)			All Other Compensation (\$)(4)
		Salary (\$)	Bonus (\$)(1)	Other Annual Compensation (\$)	Awards		Payouts	
					Restricted Stock Award(s) (\$)(7)	Securities Underlying Options (#)	Long-Term Incentive Plan Payouts (\$)(3)	
Steven S. Reinemund Director; Chairman of the Board and Chief Executive Officer	2004	1,000,000	4,500,000	170,730(5)	4,157,150(8)	353,198	0	5,154
	2003	1,000,000	3,800,000	149,393(5)	—	864,717	809,325	0
	2002	1,000,000	3,150,000	158,013(5)	—	758,357	844,800	0
Indra K. Nooyi Director; President and Chief Financial Officer	2004	767,308	1,845,023	94,221(5)	6,033,121(9)	88,444	0	0
	2003	721,154	1,486,620	125,790(5)	—	235,379	0	0
	2002	700,000	1,350,000	7,064	—	175,932	0	0
Michael D. White Chairman and Chief Executive Officer, PepsiCo International	2004	767,308	1,989,947	129,979(6)	6,033,121(10)	88,444	0	1,784
	2003	721,154	1,449,590	1,462,024(6)	—	235,966	0	0
	2002	600,000	782,700	(49,652)(6)	—	147,180	0	0
Gary M. Rodkin Chairman and Chief Executive Officer, PepsiCo Beverages and Foods North America	2004	746,154	1,590,757	42,813(5)	688,763(11)	59,259	0	4,458
	2003	721,154	1,377,320	60,018(5)	—	186,932	503,415	0
	2002	673,076	1,057,470	8,684	—	569,782	389,813	0
Abelardo E. Bru (13) Vice Chairman	2004	746,154	1,375,000	104,542(5)	826,497(12)	70,920	0	6,500
	2003	721,154	1,154,270	82,266(5)	—	231,366	0	0
	2002	650,000	531,700	52,399(5)	—	495,565	0	0

(1) Bonuses are paid after the end of the year based on performance for that year (e.g., 2004 bonus reflects 2004 performance).

(2) Long-Term Awards are made at the beginning of the year based on performance during the prior year (e.g., the 2004 Long Term Award reflects 2003 performance).

(3) Long term payouts are based on performance during the prior three-year period (e.g., the 2003 payout reflects performance during 2000-2002).

(4) Amounts represent the Company matching contribution to the PepsiCo Salaried Employee 401(k) Plan. Executive deferrals into the 401(k) Plan and Company matching contributions are limited by IRS regulations. PepsiCo does not provide an excess plan to offset 401(k) limitations.

(5) Amounts include benefits from the use of corporate transportation of \$146,593 in 2004, \$125,256 in 2003 and \$134,065 in 2002 for Mr. Reinemund; \$68,884 in 2004 and \$102,852 in 2003 for Ms. Nooyi; 19,857 in 2004 and \$29,616 in 2003 for Mr. Rodkin; and \$80,873 in 2004, \$58,597 in 2003 and \$28,730 in 2002 for Mr. Bru. Mr. Rodkin's amount for 2003 also includes \$7,468 paid in connection with his relocation to assume his new responsibilities as Chairman and Chief Executive Officer of PepsiCo Beverages and Foods North America.



- (6) Amounts include (i) benefits from the use of corporate transportation of \$34,724 in 2004 and \$11,930 in 2003; (ii) customary payments generally applicable to employees who have been temporarily assigned outside their home country, including incremental taxes of \$70,086 in 2004 and \$1,173,313 in 2003 that were required to be paid primarily to Switzerland as a result of Mr. White's multi-year assignment outside of the United States. The 2003 amounts also include \$167,954 paid in connection with Mr. White's repatriation from Switzerland to assume his new responsibility as Chairman and Chief Executive Officer of PepsiCo International.
- (7) Restricted stock units have no value to the recipient until the restrictions are released. The restrictions on any performance-based restricted stock units will be released only upon the achievement of performance targets over a predetermined performance period. Restrictions on any service-based restricted stock units will be released at a future date provided that the recipient remains continuously employed by the Company through that date. During the restriction period, restricted stock units accrue dividend equivalents at the same rate as dividends paid to shareholders. These dividend equivalents will be paid only if the underlying restricted stock units are earned.
- (8) On February 1, 2004, Mr. Reinemund received a grant of 87,982 performance-based restricted stock units having a value of \$4,157,150 on that date. Restrictions on this grant will only be released upon the achievement of performance targets over the 3-year performance period (2004-2006). The value of Mr. Reinemund's restricted stock units as of December 25, 2004 was \$4,569,785 (based on the closing price of PepsiCo Common Stock on December 23, 2004).
- (9) On February 1, 2004, Ms. Nooyi received a grant of 21,865 performance-based restricted stock units having a value of \$1,033,121 on that date. Restrictions on this grant will only be released upon the achievement of performance targets over the 3-year performance period (2004-2006). Also on February 1, 2004, Ms. Nooyi received a grant of 105,820 service-based restricted stock units having a value of \$5,000,000 on that date. Restrictions on this grant will be released on February 1, 2009 provided that Ms. Nooyi remains continuously employed by the Company through that date. As of December 25, 2004, Ms. Nooyi held 127,685 restricted stock units with a value of \$6,631,959 (based on the closing price of PepsiCo Common Stock on December 23, 2004).
- (10) On February 1, 2004, Mr. White received a grant of 21,865 performance-based restricted stock units having a value of \$1,033,121 on that date. Restrictions on this grant will only be released upon the achievement of performance targets over the 3-year performance period (2004-2006). Also on February 1, 2004, Mr. White received a grant of 105,820 service-based restricted stock units having a value of \$5,000,000 on that date. Restrictions on this grant will be released on February 1, 2009 provided that Mr. White remains continuously employed by the Company through that date. As of December 25, 2004, Mr. White held 127,685 restricted stock units with a value of \$6,631,959 (based on the closing price of PepsiCo Common Stock on December 23, 2004).
- (11) On February 1, 2004, Mr. Rodkin received a grant of 14,577 performance-based restricted stock units having a value of \$688,763 on that date. Restrictions on this grant will only be released upon the achievement of performance targets over the 3-year performance period (2004-2006). As of December 25, 2004, Mr. Rodkin held 14,577 restricted stock units with a value of \$757,129 (based on the closing price of PepsiCo Common Stock on December 23, 2004).
- (12) On February 1, 2004, Mr. Bru received a grant of 17,492 performance based restricted stock units having a value of \$826,497 on that date. Restrictions on this grant will only be released upon the achievement of performance targets over the 3-year performance period (2004-2006). As of December 25, 2004, Mr. Bru held 17,492 restricted stock units with a value of \$908,534 (based on the closing price of PepsiCo Common Stock on December 23, 2004).
- (13) On September 3, 2004, the Company entered into an agreement with Mr. Bru. The terms of that agreement are summarized on page 19 of this Proxy Statement.
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## OPTION GRANTS IN LAST FISCAL YEAR

Individual Grants					Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Name	Number of Securities Underlying Options Granted(#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date	5% \$(2)	10% \$(2)
Steven S Reinemund	353,198(1)	2.50%	\$47.25	1/31/2014	\$10,495,374	\$26,597,339
Indra K. Nooyi	88,444(1)	0.63%	\$47.25	1/31/2014	\$ 2,628,137	\$ 6,660,216
Michael D. White	88,444(1)	0.63%	\$47.25	1/31/2014	\$ 2,628,137	\$ 6,660,216
Gary M. Rodkin	59,259(1)	0.42%	\$47.25	1/31/2014	\$ 1,760,897	\$ 4,462,459
Abelardo E. Bru	70,920(1)	0.50%	\$47.25	1/31/2014	\$ 2,107,407	\$ 5,340,583

(1) These options become exercisable on February 1, 2007.

(2) The 5% and 10% rates of appreciation were set by the Securities and Exchange Commission and are not intended to forecast future appreciation, if any, of PepsiCo's Common Stock. If PepsiCo's Common Stock does not increase in value above the exercise or base price as shown in the table, then the option grants described in the table will be valueless.

## AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FY-END OPTION VALUES (1)

Name	Shares Acquired on Exercise(#)	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year-End		Value of Unexercised In the Money Options at Fiscal Year-End	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Steven S Reinemund	354,972	\$8,132,110	2,473,971	3,476,272	\$48,412,717	\$23,313,611
Indra K. Nooyi	117,868	\$2,791,461	675,571	1,170,232	\$ 9,293,996	\$ 7,813,609
Michael D. White	2,512	\$ 101,485	774,158	686,387	\$12,088,319	\$ 5,444,206
Gary M. Rodkin	60,000	\$1,362,024	774,001	1,115,973	\$12,430,970	\$ 9,944,003
Abelardo E. Bru	52,305	\$1,103,519	907,163	930,088	\$13,415,033	\$ 8,941,125

(1) The closing price of PepsiCo Common Stock on December 23, 2004, the last trading day prior to PepsiCo's fiscal year end, was \$51.94.

## EMPLOYMENT ARRANGEMENTS

*Abelardo E. Bru's Agreement.* PepsiCo and Mr. Abelardo E. Bru entered into an agreement on September 3, 2004, the material terms of which were approved by the Compensation Committee of the Board of Directors.

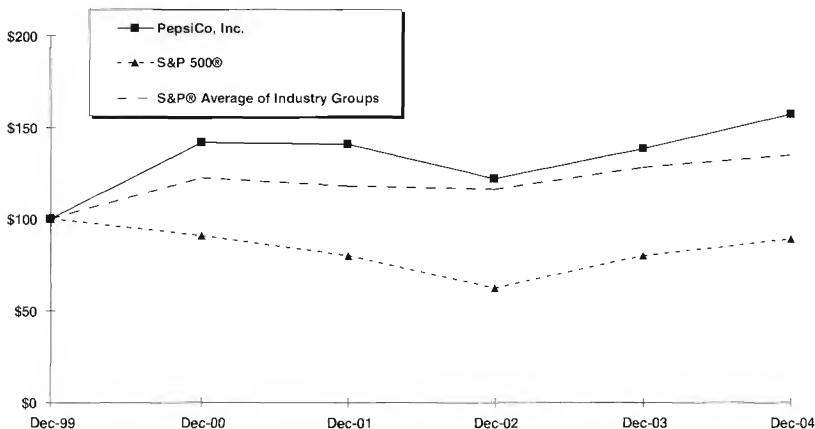
Under the agreement Mr. Bru served as Vice Chairman of PepsiCo until his retirement on February 1, 2005. Under the agreement, Mr. Bru will remain available to consult with the company for three years following his retirement and, during this period, he is prohibited from disclosing the Company's confidential information, competing against the Company, and soliciting the Company's employees. In addition, the agreement provides for each party's release of the other from legal claims. Mr. Bru will be paid \$160,000 per month during the consulting period and will be reimbursed for any reasonable business expenses.

On his retirement date, Mr. Bru became entitled to a pension benefit determined under the normal provisions of the Company's pension plan, including recognition of the consulting period for purposes of the age and service components of the benefit formula. All of Mr. Bru's equity-based awards will be treated in accordance with their original terms, including the forfeiture of any stock options that are not scheduled to vest on his retirement date, except that Mr. Bru will be permitted to continue to vest in one grant of stock options that is scheduled to vest during the three-year consulting period.

## PERFORMANCE GRAPH

The line below labeled S&P Average of Industry Groups is derived by weighting the returns of two applicable S&P Industry Groups (Non-Alcoholic Beverages and Food) by PepsiCo's sales in its Beverage and Food businesses. The return on PepsiCo stock investment is calculated through the last trading day of PepsiCo's fiscal year end, December 23, 2004. The return for the S&P 500 and the S&P Average indices is calculated through December 31, 2004.

**CUMULATIVE TOTAL RETURN,  
using PepsiCo's quarterly revenue weightings**



## **PENSION PLAN TABLE**

When an executive retires at the normal retirement age (65), the approximate annual benefits payable after January 1, 2005 for the following pay classifications and years of service are:

Remuneration	Years of Service					
	15	20	25	30	35	40
\$1,000,000	346,900	395,870	444,840	493,810	542,780	592,780
\$1,250,000	434,400	495,870	557,340	618,810	680,280	742,780
\$1,500,000	522,900	595,870	669,840	743,810	817,780	892,780
\$1,750,000	609,400	695,870	782,340	868,810	955,280	1,042,780
\$2,000,000	696,900	795,870	894,840	993,810	1,092,780	1,192,780
\$2,500,000	871,900	995,870	1,119,840	1,243,810	1,367,780	1,492,780
\$3,000,000	1,046,900	1,095,870	1,344,840	1,493,810	1,642,780	1,792,780
\$3,500,000	1,221,900	1,395,870	1,569,840	1,743,810	1,917,780	2,092,780
\$4,000,000	1,396,900	1,595,870	1,794,840	1,993,810	2,192,780	2,392,780
\$4,500,000	1,571,900	1,795,870	2,019,840	2,243,810	2,467,780	2,692,780
\$5,000,000	1,746,900	1,995,870	2,244,840	2,493,810	2,742,780	2,992,780

The pay covered by the Pension Plans noted below is based on the salary and bonus shown in the Summary Compensation Table in this Proxy Statement for each of our five most highly compensated executive officers. The years of credited service as of January 1, 2005 for the executive officers named on the Summary Compensation Table are: Steven S Reinemund—20 years; Indra K. Nooyi—10 years; Michael D. White—15 years; Gary M. Rodkin—9 years; and Abelardo E. Bru—31 years.

### ***Computation of Benefits***

PepsiCo's executive officers generally participate in PepsiCo's Retirement Plan and PepsiCo's Pension Equalization Plan (which has been adopted to provide benefits that would have been payable under the Retirement Plan except for ERISA and Internal Revenue Code limitations). The annual benefits payable under these two Pension Plans to employees with 5 or more years of service at age 65 are, for the first 10 years of credited service, 3% of the employee's highest consecutive five-year average annual earnings plus an additional 1% of the employee's highest consecutive five-year average annual earnings for each additional year of credited service over 10 years, less 0.43% of final average earnings not to exceed Social Security covered compensation multiplied by years of service (not to exceed 35 years).

## **SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16 of the Securities Exchange Act of 1934 requires PepsiCo's directors and executive officers to file reports of ownership and changes in ownership of PepsiCo Common and Convertible Preferred Stock. We received written representations from each such person who did not file an annual report with the SEC on Form 5 that no Form 5 was due. To the best of PepsiCo's knowledge, in 2004, all required forms were filed on time with the Securities and Exchange Commission, except filings with respect to the purchase of 85 shares by John F. Akers and the gift of 35 shares by Mrs. Sharon P. Rockefeller. Once the information was discovered, Forms 4 were promptly filed.



## **RATIFICATION OF APPOINTMENT OF AUDITORS (PROXY ITEM NO. 2)**

The Audit Committee engaged KPMG LLP ("KPMG") as PepsiCo's independent auditors for 2005, subject to ratification by shareholders. KPMG has been PepsiCo's independent auditors since 1990.

Representatives of KPMG will be available to answer appropriate questions at the Annual Meeting and are free to make statements during the meeting.

**The Board of Directors recommends that shareholders vote FOR the ratification of the appointment of KPMG as PepsiCo's independent auditors for 2005.**

## **SHAREHOLDER PROPOSAL**

If proposals are submitted by more than one shareholder, PepsiCo will only list the primary filer's name, address and number of shares held. We will provide information about co-filers promptly if we receive a request for the information.

## **POLITICAL CONTRIBUTIONS (PROXY ITEM NO. 3)**

Mrs. Evelyn Y. Davis, Watergate Office Building, 2600 Virginia Avenue, N.W., Washington, D.C. 20037, who owns 900 shares of PepsiCo Common Stock, has submitted the following resolution for the reasons stated:

"RESOLVED: That the stockholders recommend that the Board direct management that within five days after approval by the shareholders of this proposal, the management shall publish in newspapers of general circulation in the cities of New York, Washington, D.C., Detroit, Chicago, San Francisco, Los Angeles, Dallas, Houston and Miami, and in the Wall Street Journal and U.S.A Today, a detailed statement of each contribution made by the Company, either directly or indirectly, within the immediately preceding fiscal year, in respect of a political campaign, political party, referendum or citizens' initiative, or attempts to influence legislation, specifying the date and amount of each such contribution, and the person or organization to whom the contribution was made. Subsequent to this initial disclosure, the management shall cause like data to be included in each succeeding report to shareholders. And if no such disbursements were made, to have that fact publicized in the same manner.

REASONS: This proposal, if adopted, would require the management to advise the shareholders how many corporate dollars are being spent for political purposes and to specify what political causes the management seeks to promote with those funds. It is therefore no more than a requirement that the shareholders be given a more detailed accounting of these special purpose expenditures that they now receive. These political contributions are made with dollars that belong to the shareholders as a group and they are entitled to know how they are being spent. Last year the owners of 51,393,241 shares, representing approximately 4.6% of shares voting, voted FOR this proposal.

If you AGREE, please mark your proxy FOR this resolution."

**Response:** Under applicable law, PepsiCo makes no corporate contributions to federal candidates. We do make occasional contributions to state and local candidates where permitted by law. In each instance, we fully comply with all applicable reporting and public disclosure requirements. PepsiCo and its operating units also participate in business-oriented political and civic associations, and make their positions known on legislation that is significant to our business. The Board of Directors believes that these are important efforts, which should not be hindered by special disclosure rules that are not required by any federal, state or local regulatory authority. In addition, while we understand that the proponent has submitted a similar proposal to a number of other companies, whose shareholders may or may not adopt such proposal, PepsiCo would be comparatively disadvantaged if it was subject to special disclosure rules.

**The Board of Directors recommends that shareholders vote AGAINST this resolution.**

## **OTHER MATTERS**

The Board of Directors knows of no other matters to be brought before the Annual Meeting.

## **2006 SHAREHOLDERS' PROPOSALS**

PepsiCo welcomes comments or suggestions from its shareholders. If a shareholder wants to have a proposal formally considered at the 2006 Annual Meeting of Shareholders, and included in the Proxy Statement for that Meeting, we must receive the proposal in writing on or before November 24, 2005. In addition, if a shareholder proposal is not received by us on or before February 3, 2006, under PepsiCo's By-Laws it will not be considered or voted on at the Annual Meeting.

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## **GENERAL**

PepsiCo will pay the costs relating to this Proxy Statement, the proxy and the Annual Meeting.

In addition to the solicitation of proxies by mail, PepsiCo intends to ask brokers and bank nominees to solicit proxies from their principals and will pay the brokers and bank nominees their expenses for the solicitation.

To be sure that we have the necessary quorum to hold the Annual Meeting, PepsiCo has hired the firm of Georgeson Shareholder Communications Inc. to help in soliciting proxies by mail, telephone and personal interview for fees estimated at approximately \$21,000.

Employees of PepsiCo may also solicit proxies. They will not receive any additional pay for the solicitation.

The Annual Report to Shareholders for 2004, including financial statements, was mailed with this Proxy Statement or was previously delivered to shareholders and is not part of the material for the solicitation of proxies. To reduce postage costs, we sent materials at bulk mail rates. If you have not received the Annual Report by the time you receive your Proxy Statement, please contact PepsiCo's Manager of Shareholder Relations, at PepsiCo, Inc., 700 Anderson Hill Road, Purchase, NY 10577 or (914) 253-3055.

A copy of PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 25, 2004 (without exhibits) will be sent to any shareholder without charge by contacting the Company at the address or phone number listed above. You also may obtain our Annual Report on Form 10-K over the Internet at the Securities and Exchange Commission's website, [www.sec.gov](http://www.sec.gov), or at our website, [www.pepsico.com](http://www.pepsico.com).

Please vote your shares promptly through any of the means described on the enclosed proxy card.

By order of the Board of Directors,

A handwritten signature in dark ink, appearing to read 'L. Thompson', with a long horizontal flourish extending to the right.

Larry D. Thompson  
Secretary





**PepsiCo, Inc.**

**CORPORATE GOVERNANCE GUIDELINES**

**As of November 19, 2004**

The Board of Directors (the "Board") of PepsiCo, Inc. (the "Corporation"), acting on the recommendation of its Nominating and Corporate Governance Committee, has developed and adopted certain corporate governance principles (the "Guidelines") establishing a common set of expectations to assist the Board and its committees in performing their duties in compliance with applicable requirements. In recognition of the continuing discussions about corporate governance, the Board will review and, if appropriate, revise these Guidelines from time to time.

**A. *Director Responsibilities***

1. Represent the interests of the Corporation's shareholders in maintaining and enhancing the success of the Corporation's business, including optimizing long-term returns to increase shareholder value.
2. Selection and evaluation of a well-qualified Chief Executive Officer ("CEO") of high integrity, and approval of other members of the senior management team.
3. Oversee and interact with senior management with respect to key aspects of the business including strategic planning, management development and succession, operating performance, and shareholder returns.
4. Provide general advice and counsel to the Corporation's CEO and senior executives.
5. Adopt and oversee compliance with the Corporation's Worldwide Code of Conduct. Promptly disclose any waivers of the Code of Conduct for Directors or executive officers.
6. Hold regularly scheduled executive sessions of independent directors. Designate and publicly disclose the name of the Director who will preside at such meetings. Formally evaluate the performance of the CEO and senior management each year in executive sessions.
7. Regular attendance at Board meetings is mandatory. Meeting materials should be reviewed in advance.
8. *Duty of Care:* In discharging the duties of a Director, including duties as a Committee member, North Carolina law requires that a Director shall act: (1) in good faith; (2) with care an ordinary prudent person in a like position would exercise under similar circumstances and (3) in a manner he or she believes to be in the best interests of the Corporation.

**B. *Director Qualification Standards***

1. The Nominating and Corporate Governance Committee, with the input of the CEO, is responsible for recommending to the Board (1) nominees for Board membership to fill vacancies or newly created positions and (2) the persons to be nominated by the Board for election at the Corporation's Annual Meeting of Shareholders. The Nominating and Corporate Governance Committee does not solicit Director nominations, but will consider recommendations sent to the Secretary of the Corporation at 700 Anderson Hill Road, Purchase, New York 10577.
2. In connection with the selection and nomination process, the Nominating and Corporate Governance Committee shall review the desired experience, mix of skills and other qualities to assure appropriate Board composition, taking into account the

current Board members and the specific needs of the Corporation and the Board. The Board will generally look for individuals who have displayed high ethical standards, integrity, and sound business judgment. This process is designed to ensure that the Board includes members with diverse backgrounds, skills, and experience, including appropriate financial and other expertise relevant to the business of the Corporation.

3. Independent directors must comprise a majority of the Board.
4. An independent director of the Corporation is a director who:
  - (a) is not and has not been an employee, and does not have an immediate family member<sup>1</sup> who is or has been an executive officer<sup>2</sup>, of the Corporation, or any of its consolidated subsidiaries, during the last three years;
  - (b) has not received, and does not have an immediate family member who has received, more than \$100,000 in direct compensation from the Corporation, or any of its consolidated subsidiaries, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service) during any twelve month period within the last three years;
  - (c) (i) is not, and does not have an immediate family member that is, a current partner of a firm that is the Corporation's, or any of its consolidated subsidiaries', internal or external auditor; (ii) is not a current employee of such external audit firm; (iii) does not have an immediate family member who is a current employee of such external audit firm who participates in such firm's audit, assurance or tax compliance (but not tax planning) practice; and (iv) was not, and does not have an immediate family member that was, within the last three years (but is no longer) a partner or employee of such external audit firm who personally worked on the Corporation's, or any of its consolidated subsidiaries', audit within that time;
  - (d) is not and has not been, and does not have an immediate family member who is or has been, within the last three years, employed as an executive officer of another company where any of the Corporation's, or any of its consolidated subsidiaries', present executive officers at the same time serves or served on such other company's compensation committee;
  - (e) is not a current employee of, and does not have an immediate family member who is a current executive officer of, another company that has made payments to, or has received payments from, the Corporation, or any of its consolidated subsidiaries, for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million or 2% of the consolidated gross revenues of such other company for its last completed fiscal year; and
  - (f) has no other material relationship with the Corporation, or any of its consolidated subsidiaries, either directly or as a partner, shareholder or officer of an organization that has a material relationship with the Corporation, or any of its consolidated subsidiaries.

In making a determination regarding a proposed director's independence, the Board shall consider all relevant facts and circumstances, including the director's commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships,

<sup>1</sup> An "immediate family member" is defined to include a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law and anyone (other than domestic employees) who shares such person's home. In considering a director's independence, the Corporation need not consider individuals who are no longer immediate family members as a result of legal separation or divorce, or those who have died or become incapacitated.

<sup>2</sup> An "executive officer" means one of the Section 16 officers designated by a company.

and such other criteria as the Board may determine from time to time. If a proposed director serves as an executive officer, director or trustee of a tax exempt organization, such relationship will not be considered to be a material relationship that would impair a director's independence if contributions from the Corporation, or any of its consolidated subsidiaries, to such tax exempt organization in any of the last three fiscal years are less than the greater of (i) \$1 million or (ii) 2% of the consolidated gross revenues of such tax exempt organization for its last completed fiscal year.

5. In addition to satisfying all of the independence criteria set forth in paragraph 4 of this Section, all members of the Audit Committee must also meet the following requirements:
  - (a) Director's fees are the only compensation that members of the Audit Committee may receive from the Corporation or any of its consolidated subsidiaries. Audit Committee members may not receive consulting, advisory or other compensatory fees from the Corporation or any of its consolidated subsidiaries (other than in his or her capacity as a member of the Audit Committee, the Board of Directors, or any other committee of the Board).
  - (b) No member of the Audit Committee may be an "affiliated person" of the Corporation, or any of its consolidated subsidiaries, as such term is defined by the Securities and Exchange Commission.
6. Directors must retire at the age of 72, effective upon the expiration of their annual term at the next Annual Meeting of Shareholders.
7. The number of boards on which a Director may sit may be reviewed on a case-by-case basis by the Nominating and Corporate Governance Committee. The number of audit committees on which the Corporation's audit committee members may sit concurrently shall be reviewed annually by the Nominating and Corporate Governance Committee and the Board.
8. The Board has not established term limits for Directors. Although term limits can promote the inclusion on the Board of people with diverse perspectives, the process described in paragraph 2 of this Section can achieve the same result. Moreover, term limits have the disadvantage of causing the Corporation to lose the contributions of Directors who have been able to develop over a period of time, increasing insight into the Corporation and its operations, thereby increasing their contributions to the Corporation.
9. A Director shall offer, in writing, to resign if there is any significant change in his or her personal circumstances, including a fundamental change in his or her job responsibilities. The Chairman of the Nominating and Corporate Governance Committee may recommend, to the full Board, acceptance or rejection of such an offer after consultation with the Committee members and the Chairman of the Board.

#### **C. Board Committees**

1. The Board shall at all times have a Nominating and Corporate Governance Committee, an Audit Committee and a Compensation Committee, each comprised solely of independent directors.
2. The Board shall evaluate and determine the circumstances under which to form new Committees.

#### **D. Director Compensation**

1. Non-employee directors and committee chairs shall receive reasonable compensation for their services, as may be determined from time to time by the Board upon recommendation of the Nominating and Corporate Governance Committee. Compensation for non-employee directors and committee chairs shall be consistent

with the market practices of other similarly situated companies but shall not be at a level or in a form that would call into question the Board's objectivity. The Nominating and Corporate Governance Committee of the Board shall annually review and report to the Board with respect to director compensation and benefits.

2. Directors who are employees receive no additional pay for serving as Directors.
3. Directors who are members of the Audit Committee may receive no compensation from the Corporation other than the fees they receive for serving as Directors.

***E. Director Access to Management and Independent Advisors***

1. The Board is expected to be highly interactive with senior management. Directors are granted access to the name, location, and phone number of all employees of the Corporation.
2. It is Board policy that executive officers and other members of senior management who report directly to the CEO be present at Board meetings at the invitation of the Board. The Board encourages such executive officers and senior management to make presentations, or to include in discussions at Board meetings managers and other employees who (1) can provide insight into the matters being discussed because of their functional expertise and/or personal involvement in such matters and/or (2) are individuals with high potential whom such executive officers and senior management believe the Directors should have the opportunity to meet and evaluate.
3. Directors are authorized to consult with independent advisors, as is necessary and appropriate, without consulting management.

***F. Director Orientation and Continuing Education***

1. The Board shall implement and maintain an orientation program for newly elected directors.
2. Directors are required to continue educating themselves with respect to international markets, accounting and finance, leadership, crisis response, industry practices, general management, and strategic planning.

***G. Management Succession and CEO Compensation***

1. The Board plans for succession to the position of Chief Executive Officer. The Compensation Committee is responsible for making recommendations to the Board about succession planning. The Compensation Committee also recommends to the Board succession plans in the event of an emergency or the retirement of the CEO.
2. The CEO shall provide an annual report to the Board assessing senior managers and their potential to succeed him or her, and such report shall be reviewed by the Compensation Committee. The report shall also contain the CEO's recommendation as to his or her successor.
3. The Compensation Committee is responsible for making recommendations to the Board concerning annual and long-term performance goals for the CEO and for evaluating his or her performance against such goals.

***H. Annual Performance Evaluation of the Board***

1. The Board and its Committees will conduct a self-evaluation at least annually to determine whether it and its Committees are functioning effectively.
2. The Board will also review the Nominating and Corporate Governance Committee's periodic recommendations concerning the performance and effectiveness of the Board and its Committees.



**PepsiCo, Inc.**

**AUDIT COMMITTEE CHARTER**

(As amended, effective November 19, 2004)

**Committee Member Qualifications**

The Audit Committee (the "Committee") of the Board of Directors (the "Board") of PepsiCo, Inc. (the "Corporation") shall be comprised of members with the following qualifications:

1. The Committee shall consist entirely of independent Directors of the Board.
2. Each member of the Committee shall be free of any relationship that, in the judgment of the Board from time to time, would interfere with the exercise of his or her independent judgment.
3. Each member of the Committee shall also satisfy, in the judgment of the Board from time to time, the required financial literacy.
4. At least one member of the Committee, who, in the judgment of the Board from time to time, will have accounting or related financial management expertise.

**Committee Purpose**

The purpose of the Audit Committee is to assist the Board's oversight of:

1. the quality and integrity of the Corporation's financial statements and its related internal controls over financial reporting.
2. the Corporation's compliance with legal and regulatory requirements.
3. the independent auditor's qualifications and independence.
4. the performance of the Corporation's internal audit function and the independent auditors.

**Committee Responsibilities**

In addition to the purposes set forth above, the primary responsibilities of the Committee shall be to:

**Independent auditors**

1. Retain and terminate the Corporation's independent auditors (subject to shareholder ratification), and exercise the Committee's sole authority to approve all audit engagement fees and terms as well as non-audit engagements with the independent auditors. The Committee shall as part of such process, obtain from such independent auditors, and discuss with them, the required disclosures regarding independence, as such requirements are amended or supplemented from time to time.
2. At least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the Corporation.

### **Reporting and disclosure to the Board of Directors**

3. Meet with management and the independent auditors to review and discuss the Corporation's annual and quarterly financial statements, including significant changes in accounting principles or their application, reviewing the Corporation's specific disclosures under the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and management's certification of such statements.
4. Review regularly the independent auditor's report submitted to the Committee regarding the Corporation's critical accounting policies and practices, alternative treatments of financial information that have been discussed with management, and written communications between the Corporation's management and the independent auditors.
5. Review with the independent auditors their reports on the annual and quarterly financial statements and all communications required of the independent auditors; and discuss with the independent auditors and management their judgment as to the quality of the Corporation's accounting policies, including the application of the Corporation's accounting policies.
6. Review and discuss on a general basis the types of information disclosed in, and the types of presentations to be made for, earnings press releases, as well as financial information or earnings guidance provided to analysts and ratings agencies.
7. Review with management, the independent auditors and the senior-most internal auditor, the adequacy of the Corporation's internal controls, disclosure processes and management's responses with respect to recommendations for internal control improvements.
8. Based on the Committee's review and discussion of the Corporation's annual financial statements with management and the independent auditors, recommend to the Board that the annual financial statements be included in the Corporation's Annual Report on Form 10-K.
9. Review with management, the independent auditors and the senior-most internal auditor, the quarterly financial statements prior to the filing of quarterly periodic reports. This review includes significant adjustments, management adjustments and accounting estimates, significant new accounting policies and disagreements with management. The Chair of the Committee may represent the entire Committee for purposes of this review.
10. Review and report to the Board of Directors on any material related party transactions between the Corporation and its affiliates.
11. Regularly report Committee actions to the Board of Directors, with such recommendations, as the Committee deems appropriate.
12. Report to shareholders in the Corporation's annual proxy statement on those Committee matters required by Securities and Exchange Commission rules.
13. Annually assess and report to the Board on the performance and effectiveness of the Committee.

### **Corporate oversight**

14. Assist the Board's oversight of the Corporation's compliance with respect to its financial reporting and disclosure processes, disclosure requirements and internal control systems. Review (A) major issues regarding accounting principles and financial statement presentations, including any significant changes in the Corporation's selection or application of accounting principles, and major issues as to the adequacy of the Corporation's internal controls and any special audit steps adopted in light of

material control deficiencies; (B) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; and (C) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the Corporation.

15. Assist the Board's oversight of the audit processes of the Corporation's independent auditors and internal audit department.
16. Provide an open avenue of communication among the Corporation's independent auditors, financial and senior management, the internal auditing department, and the Board.
17. Discuss the guidelines and policies with respect to the Corporation's risk management policies and procedures.
18. Establish and maintain hiring policies for employees or former employees of independent auditors.
19. Review the audit plans and activities of the independent auditors and the internal auditors, and the coordination of their audit efforts.
20. Review and approve the performance, appointment or replacement of the Corporation's senior-most internal auditor.
21. Review the internal audit department's staffing, budget and responsibilities.
22. Review with the senior-most internal auditor and independent auditors the results of their reviews of (a) officers' expense accounts and use of corporate assets and (b) key employees' compliance with the Corporation's Code of Worldwide Business Conduct.
23. Establish procedures for the Committee to receive, retain and respond to complaints regarding the preparation of financial statements, accounting, internal accounting controls, and auditing matters.
24. Establish procedures for the Committee to receive, retain and respond to the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.
25. Establish procedures for the reporting of evidence by an attorney representing the Corporation before the Securities and Exchange Commission of a violation of securities laws or breach of fiduciary duty or similar violation by the Corporation or any agent thereof if such evidence is reported to the Corporation's Chief Legal Counsel or Chief Executive Officer and an appropriate response is not received.
26. Oversee the financial affairs, internal controls and internal and external audits of all employee benefit plans of the Corporation, its subsidiaries and divisions.
27. Name and monitor the fiduciaries of the Corporation's employee benefit plans that are subject to the Employee Retirement Income Security Act (ERISA).
28. Conduct or authorize investigations into any matters within the Committee's scope of responsibilities.
29. Consider such other matters with respect to the Corporation's financial affairs, internal controls and the internal and external audits as the Committee may deem advisable.
30. Review this Charter on an annual basis, update it as appropriate, and submit it for the approval of the Board when updated.
31. Undertake such other responsibilities or tasks as the Board may delegate or assign to the Committee from time to time.

### **General**

1. The Audit Committee shall include not less than three (3) members of the Board.
2. The Chairperson shall be appointed by the Board.
3. The Committee shall meet at least four (4) times each year, or more frequently as circumstances require.
4. The timing of the meetings shall be determined by the Committee and the Board. The Committee, however, will meet at any time that the independent auditors believe communication to the Committee is required.
5. The Board may at any time and in its complete discretion remove any member of the Committee and may fill any vacancy in the Committee.
6. A majority of the total number of members shall constitute a quorum of the Committee.
7. A majority of the members of the Committee shall be empowered to act on behalf of the Committee, except as provided otherwise in this charter.
8. Obtain advice and assistance from outside legal, accounting, or other advisers as is necessary and appropriate and approve fees for such advisors engaged by the Committee.
9. The Committee will meet, at least quarterly, with management, the senior-most internal auditor, and the independent auditors in separate sessions to discuss any matters which the Committee or these groups believe should be discussed privately with the Committee.
10. Minutes shall be kept of each meeting of the Committee, and the Committee shall regularly provide reports of its actions to the Board.







## Common Stock Information

### Stock Trading Symbol – PEP Stock Exchange Listings

The New York Stock Exchange is the principal market for PepsiCo common stock, which is also listed on the Amsterdam, Chicago, Swiss and Tokyo Stock Exchanges.

### Shareholders

At year-end 2004, there were approximately 209,000 shareholders of record.

### Dividends

We target an annual dividend payout of approximately 45% of prior year's net income from continuing operations.

Dividends are usually declared in January, May, July and November and paid at the end of March, June and September and the beginning of January. The dividend record dates for these payments are, subject to

approval of the Board of Directors, expected to be March 11, June 10, September 9 and December 9, 2005. We have paid quarterly cash dividends since 1965. Amounts in the chart reflect pre-merger PepsiCo for the dates prior to its merger with The Quaker Oats Company.

**Cash Dividends Declared**  
Per Share (in \$)



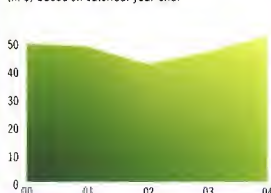
## Stock Performance

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A \$1,000 investment in our stock made on December 31, 1999 was worth about \$1,587 on December 31, 2004, assuming the reinvestment of dividends into PepsiCo stock. This performance represents a compounded annual growth rate of 10%.

The closing price for a share of PepsiCo common stock on the New York Stock Exchange was the price as reported by

Bloomberg for the years ending 2000-2004. These amounts reflect the closing price of pre-merger PepsiCo prior to our merger with The Quaker Oats Company. Past performance is not necessarily indicative of future returns on investments in PepsiCo common stock.

**Year-end Market Price of Stock**  
(in \$) Based on calendar year-end.



## Shareholder Information

### Annual Meeting

The Annual Meeting of Shareholders will be held at Frito-Lay Corporate Headquarters, 7701 Legacy Drive, Plano, Texas, on Wednesday, May 4, 2005, at 11:00 a.m. local time. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

### Inquiries Regarding Your Stock Holdings

Beneficial Shareholders (shares held by your broker in the name of the brokerage house) should direct communications on all administrative matters to your stockbroker.

Registered Shareholders (shares held by you in your name) should address communications concerning statements, dividend payments, address changes, lost certificates and

other administrative matters to:

The Bank of New York  
Shareholder Services Department  
P.O. Box 11258  
Church Street Station  
New York, NY 10286-1258  
Telephone: 800-226-0083  
610-312-5303  
(Outside the U.S.)

E-mail: [shareowner-svcs@bankofny.com](mailto:shareowner-svcs@bankofny.com)  
Website: <http://www.stockbny.com>  
or  
Manager Shareholder Relations  
PepsiCo, Inc.  
700 Anderson Hill Road  
Purchase, NY, 10577  
Telephone: 914-253-3055

In all correspondence or telephone inquiries, please mention PepsiCo, your name as printed on your stock certificate, your Social Security number, your address and telephone number.

SharePower Participants (employees with SharePower options) should address all questions regarding your account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower  
Stock Option Unit  
1600 Merrill Lynch Drive  
Mail Stop 06-02-SOP  
Pennington, NJ 08534  
Telephone: 800-837-6713  
(U.S., Puerto Rico and Canada)  
609-818-8800  
(all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your Social Security number), your address, your telephone number and mention PepsiCo SharePower. For telephone inquiries, please have a copy of your most recent statement available.

### Employee Benefit Plan Participants:

Common Stock Purchase Program  
Fidelity Investments  
P.O. Box 77001  
Cincinnati, OH 45277-0002  
Telephone: 800-544-9354  
(U.S., Puerto Rico and Canada)  
800-544-0275  
(all other locations)

E-mail, go to <http://www.fidelity.com>, select "Customer Service," then "Contact Us."

PepsiCo 401(k) Plan  
Fidelity Investments  
P.O. Box 9029  
Boston, MA 02205  
Telephone: 800-883-4015  
877-833-9800  
(Outside U.S.)

Please have a copy of your most recent statement available when calling with inquiries.

## Shareholder Services

### Dividend Reinvestment Plan

A brochure explaining this convenient plan, for which PepsiCo pays all administrative costs, is available from our transfer agent:

The Bank of New York  
Dividend Reinvestment Department  
P.O. Box 1958  
Newark, NJ 07101-9774  
Telephone: 800-226-0083

### Direct Deposit of Dividends

Information on the Direct Deposit service is available from our transfer agent:

The Bank of New York  
Shareholder Services Department  
P.O. Box 11258  
Church Street Station  
New York, NY 10286-1258  
Telephone: 800-226-0083  
610-312-5303  
(Outside the U.S.)

### Financial and Other Information

PepsiCo's 2005 quarterly earnings releases are expected to be issued the week of April 11, July 11, September 26, 2005, and January 29, 2006.

Copies of PepsiCo's SEC reports, earnings and other financial releases, corporate news and additional company information are available on our website <http://www.pepsico.com> or contact PepsiCo's Manager of Shareholder Relations at (914) 253-3055.

If you have questions regarding PepsiCo's financial performance contact:

Jamie Caulfield  
Vice President, Investor Relations  
PepsiCo, Inc.  
Purchase, NY 10577  
Telephone: 914-253-3035

### Independent Registered Public Accounting Firm

KPMG LLP  
345 Park Avenue  
New York, NY 10154-0102  
Telephone: 212-758-9700

### Corporate Headquarters

PepsiCo, Inc.  
700 Anderson Hill Road  
Purchase, NY 10577  
Telephone: 914-253-2000

### PepsiCo Website

<http://www.pepsico.com>

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